

# Loss Aversion and the Law

*Eyal Zamir\**

|   |     |
|---|-----|
| INTRODUCTION .....  | 830 |
| I. LOSS AVERSION: AN OVERVIEW .....   | 834 |
| II. BASELINES, LOSS AVERSION, AND THE LAW .....   | 843 |
| A. <i>Tort Law vs. Unjust Enrichment</i> .....  | 843 |
| B. <i>Constitutional Property Law: Takings vs. Givings</i> .....                                      | 848 |
| C. <i>Remedies for Breach of Contract: Reliance, Expectation, Restitution, and Disgorgement</i> ..... | 852 |
| D. <i>Civil-Rights Law: Affirmative Action</i> .....  | 860 |
| E. <i>Additional Examples</i> .....   | 864 |
| III. EXPLAINING THE COMPATIBILITY BETWEEN LAW AND PSYCHOLOGY .....                                    | 869 |
| A. <i>Evolutionary Theories: Plaintiffs' Role</i> .....   | 870 |
| B. <i>Cognitive Psychology, Commonsense Morality, and the Law</i> .....                               | 876 |
| IV. NORMATIVE IMPLICATIONS .....  | 885 |
| A. <i>Positive and Normative Analyses</i> .....   | 885 |
| B. <i>Justifying Basic Features of Extant Law</i> .....   | 886 |
| C. <i>Law's Determination of Reference Points</i> .....   | 889 |
| D. <i>Lawmakers' Loss Aversion</i> .....  | 892 |

---

\* Augusto Levi Professor of Commercial Law, Hebrew University of Jerusalem. I would like to thank Katya Assaf, Adi Ayal, Shmuel Becher, Uri Benoliel, Ilan Benschalom, Devon Carbado, Hanoch Dagan, David Enoch, Yuval Feldman, David Gliksberg, Assaf Hamdani, Daniel Kahneman, Russell Korobkin, Ronit Levine-Schnur, Daphna Lewinsohn-Zamir, Amir Licht, Barak Medina, Michael Pardo, Frank Partnoy, Ariel Porat, Eric Posner, Jeffrey Rachlinski, Ilana Ritov, Michal Shur-Ofry, Dan Simon, Alex Stein, Doron Teichman, Avishalom Tor, Fredrick Vars, Adrian Vermeule, and participants in seminars and colloquia held at the Academic Center of Law and Business, Haifa University, Hebrew University of Jerusalem, Tel Aviv University, UCLA School of Law, University of San Diego School of Law, and USC Gould School of Law for invaluable comments on earlier drafts of this Article. Thanks are also due to Greg Klass, Donald Langevoort, John Mikhail, and Kathryn Zeiler for fruitful discussions. Special thanks are due to Netta Barak-Corren and Talia Ben Sasson-Gordis for excellent research assistance. This research was supported by the Israel Science Foundation (grant No. 100/11), the Milton and Miriam Handler Foundation, the Aharon Barak Center for Interdisciplinary Legal Research, and the Faculty of Law of the Hebrew University.

|                  |     |
|------------------|-----|
| CONCLUSION ..... | 894 |
|------------------|-----|

## INTRODUCTION

According to the rational choice theory of human behavior—the predominant theory in economics and an influential theory in other disciplines, including law—people strive to enhance their own well-being. Among the available options, they rationally choose the one that would maximize their expected utility, determined in absolute terms.

In 1979, Daniel Kahneman and Amos Tversky offered a competing descriptive theory of people’s preferences and choices under risk, known as Prospect Theory (“PT”).<sup>1</sup> This theory differs from the rational choice theory in several respects. First and foremost, the theory posits that people generally do not perceive outcomes as final states of wealth or welfare, but rather as gains and losses. Gains and losses are defined relative to a baseline or reference point. The value function is normally steeper for losses than gains, indicating loss aversion. People’s choices therefore crucially depend on the way that they frame any choice. In particular, an individual’s reference point determines whether she perceives changes as gains or losses. Usually, but not invariably, people take the status quo as the baseline. The centrality of reference points and the notion that losses loom larger than gains hold true for risky and riskless choices alike.<sup>2</sup>

PT and related psychological phenomena, such as the endowment effect and the status quo bias,<sup>3</sup> have had a significant impact on legal theory. Dozens of studies have analyzed their implications for a range of legal doctrines in various contexts. Typically, these studies will do one or more of the following: highlight the contribution of PT to improve the understanding of human behavior in legal contexts; advise legal actors how to take the theory’s implications into account in interactive legal encounters; or analyze its

---

1. Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263 (1979).

2. See Richard H. Thaler, *Toward a Positive Theory of Consumer Choice*, 1 *J. ECON. BEHAV. & ORG.* 39, 43–47 (1980) (introducing the “endowment effect” whereby individuals tend to value things they already own more greatly than things they do not own); Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 *Q.J. ECON.* 1039 (1991) (applying the notions of reference dependence and loss aversion to riskless choices); Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economists*, 93 *AM. ECON. REV.* 1449, 1457 (2003) (highlighting the importance of reference dependence and loss aversion in risky and riskless choice).

3. See *infra* notes 14, 17, 32–37 and accompanying text.

significance for legal policymaking on a variety of issues.<sup>4</sup> The present Article is more ambitious. It argues that the notions of reference points and loss aversion permeate the law and illuminate fundamental characteristics of the legal system itself. Reference points and loss aversion may explain basic features of entire legal fields and even the relative importance of different fields within the legal system. In addition, the Article offers new explanatory theories regarding the compatibility of the cognitive phenomenon of loss aversion and law's fundamental characteristics and presents a comprehensive analysis of the normative implications of loss aversion for law and lawmaking.<sup>5</sup>

Consider the tort/unjust-enrichment puzzle, the anomalous takings/givings disparity, and the centrality of the "interests" in contract remedies. The first, recently revisited by Ariel Porat and Giuseppe Dari-Mattiacci,<sup>6</sup> concerns the fact that a person's behavior often creates negative and positive external effects for others, without their consent. From an economic perspective, the actor should internalize both negative and positive externalities to induce efficient behavior. However, in practically all legal systems, the law of tort, which requires injurers to pay for their negative externalities, is far more developed and effective than the law of unjust enrichment, which entitles benefactors to recover the benefits they confer on others.

The takings/givings anomaly, brought to the fore several years ago by Abraham Bell and Gideon Parchomovsky,<sup>7</sup> refers to the

---

4. See *infra* notes 49–53 and accompanying text.

5. For a previous attempt to explain a range of legal doctrines through the lenses of the disparate valuations of losses and gains, see David Cohen & Jack L. Knetsch, *Judicial Choice and Disparities Between Measures of Economic Values*, 30 OSGOODE HALL L.J. 737 (1992). The present Article differs from that fine article in important respects. While Cohen and Knetsch focused on judicial decisions (mostly Canadian and English), the present Article discusses all sources of law, including statutory and constitutional norms, drawing primarily from U.S. law. More importantly, most of the doctrines discussed by Cohen and Knetsch are somewhat peculiar (e.g., the role of motives in contract breaches and the common law reluctance to enforce contract modifications unsupported by consideration and gratuitous promises) and some are rather questionable (e.g., Cohen and Knetsch interpret remedies for breach of contract as primarily protecting the reliance interest; see also *infra* Part II.C). In contrast, the present Article focuses on fundamental characteristics of entire legal fields. It also more fully explores competing explanations for the phenomena it discusses, examines theories that may account for the compatibility between psychological findings and the law, and discusses the normative implications of the analysis. Finally, this Article reflects recent advancements in psychological research.

6. Giuseppe Dari-Mattiacci, *Negative Liability*, 38 J. LEGAL STUD. 21 (2009); Ariel Porat, *Private Production of Public Goods: Liability for Unrequested Benefits*, 108 MICH. L. REV. 189 (2009).

7. Abraham Bell & Gideon Parchomovsky, *Givings*, 111 YALE L.J. 547 (2001).

fundamentally different ways that law and legal theory treat governmental takings of private property and other entitlements as opposed to governmental givings of entitlements. While most liberal legal systems set legal or even constitutional limits on takings and require adequate compensation for at least some forms of takings, the limits on governmental givings and the requirement to charge the recipients for such benefits are much weaker. This disparate treatment of governmental takings and givings is apparently incompatible with the pertinent efficiency, distribution, and fairness considerations.

The third illustration concerns contract remedies. Conventionally, remedies for breach of contract are thought of as protecting the injured party's expectation interest, though some renowned scholars have argued that contract law should and does protect the reliance interest, and others have claimed that it should also protect the disgorgement interest. Despite the equivocal arguments against broader availability of disgorgement remedies, these remedies are marginal in practically all legal systems. More fundamentally, over a decade ago, Richard Craswell powerfully challenged the descriptive and normative usefulness of the conventional classification of the different interests protected by contract remedies.<sup>8</sup> He argued that none of the major theories of contract law is necessarily committed to specifically protecting any of the recognized interests. Nevertheless, two striking features of contract law are (a) the enduring recourse of contract doctrine and theory to the conventional classification, and (b) the basic denial of protection for the disgorgement interest.

Various explanations and justifications have been offered for these and similar puzzles. Without dismissing other explanations, this Article claims that these puzzles can at least partially be explained by, or better understood through, the notions of reference points and loss aversion. Contrary to some normative theories, and in keeping with the way people think and reason in general, the law is structured around various baselines. Since losses loom larger than gains, the law more readily and effectively rectifies unjustified losses than helps people recover gains that they failed to obtain.

In addition to establishing the connection between loss aversion and the law, the Article strives to explain their compatibility. One explanation is evolutionary, drawing in part on the "efficiency of the common law" theory proposed by legal economists. Since people find losses more painful than unobtained gains, they file lawsuits for

---

8. Richard Craswell, *Against Fuller and Perdue*, 67 U. CHI. L. REV. 99 (2000).

recovery of losses far more often than for unobtained gains. As a result, legal doctrines dealing with the former are much more developed than those dealing with the latter.

Another explanation is based on the mindset of legal rulemakers, such as legislators and judges. It contends that legal thinking largely follows commonsense morality, which generally conforms to moderate deontology. As such, the law performs and distinguishes between harming people and not aiding them, which in turn presupposes the existence of a baseline. Since prevailing moral intuitions embody baselines and a prohibition against harming other people (far more than a duty to benefit others), these notions are also manifest in the law. This explanation points to an important correspondence between psychology, morality, and law.

The analysis also has important normative implications. Primarily, if due to loss aversion the decrease in people's well-being when they do not get something is considerably smaller than when something is taken from them, then, *ceteris paribus*, the law should favor not giving over taking. To the extent that the law strives to enhance human well-being, it should concentrate on redressing losses, rather than on entitling people to recover unattained gains.

The normative implications (and to some extent, the explanatory arguments) are complicated by the interaction between the law and people's perceptions. A central insight of PT is that the reference point by which people assess gains and losses is to some extent unfixed and manipulable. This malleability means that, by setting baselines, the law may affect people's perceptions, judgments, and choices. This observation cautions against any hasty move from explanation to justification. It also provides a *prima facie* reason to be cautious about legal reforms entailing both gainers and losers. When considering such reforms, the gains and losses should be weighted differently, as the latter loom larger than the former. Moreover, since the new legal regime may create a new baseline, undoing the reform and restoring the preexisting legal order is likely to be rather difficult.

As opposed to these conservative arguments, the recognition that the law not only mirrors people's reference points, but also sometimes shapes them, may lead to progressive and even radical normative conclusions. It calls for critical reexamination of those doctrines and policies that rest on questionable framings of the pertinent issues and opens the door to using the law as a means to reframe perceptions. Lawmakers' own loss aversion is thus a cause for concern.

The Article begins in Part I with a short overview of the vast psychological literature on loss aversion. Part II then demonstrates

how several fundamental features of law, which are seemingly inexplicable, can be better understood through the lenses of baselines and loss aversion. The primary examples are taken from a number of legal fields, including tort and unjust enrichment (the costs/benefits puzzle), constitutional property law (the takings/givings anomaly), contract law (the goals of contract remedies), and civil-rights law (hiring versus firing in affirmative-action plans). Others come from fields including human-rights law (civil and political versus social and economic rights), criminal law (the defense of necessity), tax law (tax deductions), and evidence law (burden of proof in civil litigation).

Part III discusses two theories that may explain the centrality of loss aversion in law. The first, evolutionary theory, focuses on the role of plaintiffs in the development of law. The second explains the compatibility between law and psychology via commonsense morality.

Part IV presents possible normative implications of the analysis, some of which are conservative and others progressive. They include justifying the characteristics of the law discussed in Part II, exploring the significance of the law's impact on people's reference points, and examining lawmakers' own loss aversion.

### I. LOSS AVERSION: AN OVERVIEW

*A brief history.* In 1738, Daniel Bernoulli revolutionized economic thinking by arguing that, very often, people's preferences and choices do not aim at maximizing the expected value of outcomes (the probability-weighted sum of possible random values), but rather their expected utility.<sup>9</sup> In 1944, John von Neumann and Oskar Morgenstern reinterpreted Bernoulli's theory and introduced the von Neumann-Morgenstern utility function which still serves as the basis of rational choice theory.<sup>10</sup> According to their theorem, people's preferences and choices depend not only on the expected value of different outcomes, but also on their risk aversion, which in turn depends on their overall assets. According to the law of diminishing marginal utility, the utility one derives from any additional unit of a good or service is smaller than the utility one derives from the previous unit. Expected utility theory assumes that one's assessment

---

9. Daniel Bernoulli, *Exposition of a New Theory on the Measurement of Risk* (1738), reprinted in 22 *ECONOMETRICA* 23 (Louise Sommer trans., 1954).

10. JOHN VON NEUMANN & OSKAR MORGENSTERN, *THEORY OF GAMES AND ECONOMIC BEHAVIOR* (1944).

of different outcomes is independent of any reference point. Actual losses are equivalent to foregone gains.<sup>11</sup>

This reference independence was challenged as early as the 1950s.<sup>12</sup> Only in 1979, however, did Daniel Kahneman and Amos Tversky come up with a full-fledged theory of people's decisions under risk that constituted a powerful alternative to expected utility theory: Prospect Theory.<sup>13</sup> This theory was based on experimental evidence and was formalized mathematically. In 1980, Richard Thaler used PT to explain the phenomenon that people attach greater value to things they already have than to things they have yet to acquire (which he coined the endowment effect), thus applying PT to riskless choices.<sup>14</sup> In 1992, Tversky and Kahneman presented a modified version of the original PT, extending it in several respects including to riskless (in addition to risky) decisions and to decisions involving more than two options.<sup>15</sup> PT has inspired numerous studies and had a major effect on such disciplines as cognitive psychology, economics, finance, political science, and law. In 2002, Daniel Kahneman won the Nobel Prize in economics primarily for his contribution, together with Amos Tversky (who passed away in 1996), to formulating PT.

*Prospect Theory, reference points, and loss aversion.* PT comprises several elements, all of which differ from the tenets of expected utility theory. Most importantly, PT posits that people ordinarily perceive outcomes as gains and losses, rather than as final states of wealth or welfare. Gains and losses are defined relative to a reference point. The value function is normally concave for gains

11. On expected utility theory and its role within rational choice theory, see Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1060–66 (2000).

12. See, e.g., Harry Markowitz, *The Utility of Wealth*, 60 J. POL. ECON. 151 (1952) (proposing a modified utility function that differentiates between gains and losses); Armen A. Alchian, *The Meaning of Utility Measurement*, 43 AM. ECON. REV. 26, 44–46 (1953) (discussing reference-dependent utility functions).

13. Kahneman & Tversky, *supra* note 1.

14. Thaler, *supra* note 2, at 43–47. For earlier studies documenting the gap between the maximal sum that people are willing to pay for an entitlement and the minimal sum that they are willing to accept to forgo a similar entitlement, see, for example, JUDD HAMMACK & GARDNER M. BROWN JR., *WATERFOWL AND WETLANDS: TOWARD BIO-ECONOMIC ANALYSIS* 26–27 (1974) (reporting that hunters were willing to pay an average of \$247 to continue hunting but demanded an average compensation of \$1044 to sell their hunting rights); C.H. Coombs, T.G. Bezembinder & F.M. Goode, *Testing Expectation Theories of Decision Making Without Measuring Utility or Subjective Probability*, 4 J. MATHEMATICAL PSYCHOL. 72, 80–96 (1967) (describing an experiment in which average selling prices for lottery tickets were more than twice as high as buying prices). On the endowment effect, see also *infra* notes 17, 32–36 and accompanying text.

15. Amos Tversky & Daniel Kahneman, *Advances in Prospect Theory: Cumulative Representation of Uncertainty*, 5 J. RISK & UNCERTAINTY 297 (1992).

(implying risk aversion), convex for losses (reflecting risk seeking), and generally steeper for losses than for gains. This means that the disutility generated by a loss is greater than the utility produced by a similar gain. Tversky and Kahneman estimated that monetary losses loom larger than gains by a factor of 2.25.<sup>16</sup> A meta-analysis of 164 experiments of the related phenomenon of endowment effect found that the median ratio between people's willingness to pay ("WTP") for a good they don't yet have and their willingness to accept ("WTA") to part with a similar good is 1:2.9 (with very substantial variation).<sup>17</sup> PT also posits that people's risk aversion in the domain of gains and their risk seeking in the domain of losses are reversed for low-probability gains and losses. Finally, PT postulates that the subjective weighing of probabilities systematically deviates from the objective probabilities.<sup>18</sup> The central elements of PT—what Kahneman hailed as "the core idea[s] of prospect theory"—are, however, reference dependence (the notion that "the value function is kinked at the reference point") and loss aversion.<sup>19</sup>

Significantly, PT posits that the benchmark by which people perceive outcomes as either gains or losses crucially depends on the way that they frame the scenario or choice that they face. Numerous experiments have demonstrated that people choose differently among essentially identical alternatives, depending on the way that they are induced to frame the choice problem.<sup>20</sup> Ordinarily, people take the

---

16. *Id.* at 311.

17. Serdar Sayman & Ayşe Öncüler, *Effects of Study Design Characteristics on the WTA-WTP Disparity: A Meta Analytical Framework*, 26 J. ECON. PSYCHOL. 289, 300, 302 (2005). On the endowment effect, see *infra* note 32 and accompanying text. For mathematical definitions of loss aversion, see PETER P. WAKKER, PROSPECT THEORY: FOR RISK AND AMBIGUITY 238–40, 252–54 (2010); Mohammed Abdellaoui, Han Bleichrodt & Corina Paraschiv, *Loss Aversion Under Prospect Theory: A Parameter-Free Measurement*, 53 MGMT. SCI. 1659, 1661–62 (2007).

18. Kahneman & Tversky, *supra* note 1, at 265–67, 280–84; Tversky & Kahneman, *supra* note 15, at 303, 306, 312–13.

19. Kahneman, *supra* note 2, at 1457.

20. See, e.g., Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 SCIENCE 453, 453 (1981) (describing the famous Asian disease experiment in which respondents' choice between two different medical treatments were reversed, depending on whether the data was presented in terms of expected death or expected survival); Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, 59 J. BUS. S251 (1986) (providing additional evidence of framing effects and discussing their implications); see also Anton Kühberger, *The Influence of Framing on Risky Decisions: A Meta-Analysis*, 75 ORG. BEHAV. & HUM. DECISION PROC. 23 (1998) (concluding, on the basis of meta-analysis of 136 papers, that framing is a reliable phenomenon, though different manipulations produce different sizes of this effect); Avital Moshinsky & Maya Bar-Hillel, *Loss Aversion and the Status Quo Label Bias*, 28 SOC. COGNITION 191 (2010) (finding a framing effect in a study of policy choices). On the implications of this phenomenon for legal policymaking, see *infra* notes 243–65 and accompanying text.

status quo as the reference point and view changes from this point as either gains or losses.<sup>21</sup> It has been demonstrated, however, that this assumption is primarily appropriate for contexts where people expect to maintain the status quo. When expectations differ from the status quo, as is often the case in market environments, taking people's expectations as the pertinent reference point may yield better explanations and predictions of their behavior.<sup>22</sup> The status of other people also influences an individual's perception of the reference point. For example, when an employee receives a smaller salary raise than everyone else in a workplace, she may view this raise as a loss, even though her position was improved in absolute terms.<sup>23</sup> Finally, one's reference point may change in dynamic situations. Most research suggests that people quickly adapt their reference point following the making of gains, but that they are much less inclined to adjust their reference point after incurring losses.<sup>24</sup>

*Empirical studies.* Loss aversion has been found not only in laboratory experiments around the world,<sup>25</sup> but also in a number of real-world contexts. For example, it is well known that stock rates are more volatile and riskier than treasury bills and other bonds. Yet, for

---

21. See Tversky & Kahneman, *supra* note 2, at 1046–47 (“[T]he reference state usually corresponds to the decision maker’s current position . . . [but] it can be influenced by aspirations, expectations, norms, and social comparisons.”).

22. See, e.g., Botond Köszegi & Matthew Rabin, *A Model of Reference-Dependent Preferences*, 121 Q.J. ECON. 1133 (2006) (proposing an economic model taking people's expectations as the pertinent reference point); Botond Köszegi & Matthew Rabin, *Reference-Dependent Risk Attitude*, 97 AM. ECON. REV. 1047 (2007) (extending their model, taking people's recent beliefs about the outcome as their reference point); Johannes Abeler et al., *Reference Points and Effort Provision* (Mar. 1, 2009) (unpublished manuscript) (available at <http://ssrn.com/abstract=1365135>) (providing experimental support for expectation-based reference dependence); Andreas Hack & Frauke Lammers, *The Role of Expectations in the Formation of Reference Points* (May 2009) (unpublished manuscript) (available at <http://www.smu.ca/iarepsabe09/documents/Lammers-A.pdf>) (providing experimental evidence that expectations significantly affect the formation of reference points and subsequent choices). On legal implications of this phenomenon, see *infra* notes 115–19 and accompanying text.

23. Daniel Kahneman & Amos Tversky, *Choices, Values, and Frames*, 39 AM. PSYCHOLOGIST 341, 349 (1984); cf. George F. Lowenstein, Leigh Thompson & Max H. Bazerman, *Social Utility and Decision Making in Interpersonal Contexts*, 57 J. PERSONALITY & SOC. PSYCHOL. 426 (1989) (finding that in interpersonal contexts, the outcomes of another person—rather than one's own status quo—may emerge as an alternative or additional reference point).

24. See, e.g., Hal R. Arkes et al., *Reference Point Adaptation: Tests in the Domain of Security Trading*, 105 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 67 (2008) (exposing this phenomenon in the context of security trading); Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325 (1990) (demonstrating and discussing the “instant endowment effect”).

25. For evidence of loss aversion in a nonwestern society, see, for example, Stephen J. Humphrey & Arjan Verschoor, *Decision-Making Under Risk Among Small Farmers in East Uganda*, 13 J. AFR. ECON. 44, 88–89 (2004).

many years, the gap between long-term returns on stocks and bonds has been so great that it becomes difficult to explain the demand for bonds on the basis of standard notions of risk aversion.<sup>26</sup> However, this so-called equity-premium puzzle is perfectly compatible with loss aversion, assuming investors evaluate their portfolios annually. To avoid even a small risk of loss, people are willing to forego considerable expected gains.<sup>27</sup>

Another empirically studied phenomenon that may best be explained through the notion of loss aversion is advocates' fee arrangements. Empirical data indicates that lawyers often earn a considerably higher effective hourly fee when they charge plaintiffs on a contingency fee ("CF") basis—that is, when the fee is calculated as a certain percentage of the recovery and hence no fee is paid if the claim fails—than a noncontingent fee basis.<sup>28</sup> Whereas some commentators explain this phenomenon on the basis of standard market failures,<sup>29</sup> a more compelling explanation is that while a CF is perceived as a pure positive gamble (the client may win or break even), a noncontingent fee exposes the plaintiff to a risk of loss (if the claim fails and the client still has to pay the fee). Plaintiffs are willing to pay a considerably higher expected fee to avoid even a small risk of loss.<sup>30</sup> These are but two examples of empirically studied phenomena demonstrating the crucial role that loss aversion plays in people's behavior. Numerous other examples are readily available.<sup>31</sup>

*Related phenomena.* The notions of reference points and loss aversion have also been used to explain such phenomena as the

---

26. Rajnish Mehra & Edward C. Prescott, *The Equity Premium: A Puzzle*, 15 J. MONETARY ECON. 145 (1985).

27. Shlomo Benartzi & Richard H. Thaler, *Myopic Loss Aversion and the Equity Premium Puzzle*, 110 Q.J. ECON. 73 (1995).

28. See, e.g., Herbert M. Kritzer, *Seven Dogged Myths Concerning Contingency Fees*, 80 WASH. U. L.Q. 739, 761–68 (2002) (indicating that in the early 1990s in Wisconsin, the mean effective hourly fee resulting from CF (\$242) was almost twice as large as the ordinary hourly fee (\$124)); cf. HERBERT M. KRITZER, RISKS, REPUTATIONS, AND REWARDS: CONTINGENCY FEE LEGAL PRACTICE IN THE UNITED STATES 180–218 (2004) (analyzing additional data on contingency fees for legal services).

29. See, e.g., Lester Brickman, *The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?*, 25 CARDOZO L. REV. 65, 68 (2003) (arguing that high CF rates reflect such market failures as plaintiffs' information problems and lawyers' uniform pricing practices).

30. Eyal Zamir & Ilana Ritov, *Revisiting the Debate over Attorneys' Contingent Fees: A Behavioral Analysis*, 39 J. LEGAL STUD. 245 (2010) (demonstrating that PT accounts for this and other aspects of the contingency fee market).

31. See, e.g., Colin F. Camerer, *Prospect Theory in the Wild: Evidence from the Field*, in CHOICES, VALUES, AND FRAMES 288 (Daniel Kahneman & Amos Tversky eds., 2000) (surveying numerous studies providing empirical support for PT); Stefano DellaVigna, *Psychology and Economics: Evidence from the Field*, 47 J. ECON. LITERATURE 315, 324–36 (2009) (same).

endowment effect and the status quo bias. The endowment effect, sometimes dubbed the WTA–WTP disparity, refers to the phenomenon that individuals tend to place higher value on objects and entitlements that they already have, compared to objects and entitlements that they do not have.<sup>32</sup> Arguably, parting with (at least some) objects is perceived as losing them, whereas acquiring objects is perceived as gaining them. The status quo bias refers to the phenomenon that people tend to stick to the state of affairs that they perceive as the status quo rather than opting for an alternative state.<sup>33</sup> When departing from the status quo may result in either gains or losses, people are inclined to avoid such a departure. Closely connected to an omission bias,<sup>34</sup> the status quo bias explains a robust default effect, the tendency not to opt out of default arrangements.<sup>35</sup> Interestingly, even contractual default rules, which arguably do not endow people with any entitlement unless they find a partner willing to contract with them without deviating from the default, create an endowment effect and result in a status quo bias.<sup>36</sup> Another phenomenon associated with loss aversion is the consideration of sunk costs. Contrary to the microeconomic notion that only future costs should

---

32. Thaler, *supra* note 2; see also David W. Harless, *More Laboratory Evidence on the Disparity Between Willingness to Pay and Compensation Demanded*, 11 J. ECON. BEHAV. & ORG. 359 (1989); Kahneman, Knetsch & Thaler, *supra* note 24; Jack L. Knetsch & J.A. Sinden, *Willingness to Pay and Compensation Demanded: Experimental Evidence of an Unexpected Disparity in Measures of Value*, 99 Q.J. ECON. 507 (1984).

33. See, e.g., Kahneman & Tversky, *supra* note 23, at 348 (describing an experiment in which most subjects who were asked to imagine that they hold a certain job preferred to stay in that job rather than switch to an alternative one with different characteristics—some of which were better and some worse—regardless of the job they were holding); see also Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSP. 193, 197–99 (1991); William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7 (1988) (analyzing a host of experimental and empirical studies demonstrating this bias).

34. See, e.g., Ilana Ritov & Jonathan Baron, *Status-Quo and Omission Biases*, 5 J. RISK & UNCERTAINTY 49 (1992) (finding that subjects preferred inaction even when it was associated with change).

35. See, e.g., Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149 (2001) (describing a natural experiment where changing the default from nonparticipation to participation in retirement savings dramatically increased employees' participation); see also DellaVigna, *supra* note 31, at 322 (concluding that “the finding of large default effects is one of the most robust results in the applied economics literature of the last ten years”).

36. Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608 (1998) (experimentally demonstrating the endowment effect of contract default rules); Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1760–62 (1997) (arguing that contract default rules plausibly create a default effect).

affect one's decisions, people take past investments into consideration because they dislike the notion of wasting (losing) resources.<sup>37</sup>

*Loss aversion and emotions.* Gains and losses are closely connected to emotions of pleasure and pain, and emotions are triggered by changes. A descriptive theory of choice must therefore take into consideration feelings such as the pain of loss and the regret of mistakes.<sup>38</sup> In the context of choosing among risky alternatives, the following has been demonstrated: *ex ante*, people anticipate that losses will result in a greater adverse hedonic impact than the positive impact of gains of equal magnitude; however, *ex post* people rationalize their losses and do not experience as great an adverse effect as predicted. Thus, at least sometimes, the status quo bias results from an affective forecast rather than from affective experience.<sup>39</sup>

*Evolutionary roots.* It has been hypothesized that loss aversion has biological and evolutionary roots. Laboratory experiments have indicated that the choices of capuchin monkeys displayed reference dependence and loss aversion.<sup>40</sup> More generally, numerous studies of various territorial animals reveal that defenders of a territory almost invariably overcome intruders of the same species who try to take over their territory.<sup>41</sup> Residents who face the risk of losing their territory exert more effort than challengers who try to gain new territory.<sup>42</sup> In the context of the endowment effect, it has been hypothesized that the relative security of exchange, thanks to the availability of legal and

---

37. See, e.g., Hal R. Arkes & Catherine Blumer, *The Psychology of Sunk Costs*, 35 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 124 (1985) (describing experiments demonstrating the sunk costs effect); Thaler, *supra* note 2, at 47–50 (modeling sunk costs).

38. Kahneman, *supra* note 2, at 1457, 1463.

39. Deborah A. Kermer et al., *Loss Aversion Is an Affective Forecasting Error*, 17 PSYCHOL. SCI. 649 (2006). On loss aversion, beliefs, and emotions, see also Barbara A. Mellers & Ilana Ritov, *How Beliefs Influence the Relative Magnitude of Pleasure and Pain*, 23 J. BEHAV. DECISION MAKING 369 (2010).

40. M. Keith Chen, Venkat Lakshminarayanan & Laurie R. Santos, *How Basic Are Behavioral Biases? Evidence from Capuchin Monkey Trading Behavior*, 114 J. POL. ECON. 517 (2006) (describing experiments in which monkeys learned to trade tokens for food and could choose between trading with either of two experimenters).

41. See JOHN ALCOCK, ANIMAL BEHAVIOR: AN EVOLUTIONARY APPROACH 278–84 (9th ed. 2009) (discussing theoretical and experimentally tested explanations for the phenomenon that “when a territory holder is challenged by a rival, the owner almost always wins the contest—usually within a matter of seconds”); JACK W. BRADBURY & SANDRA L. VEHRENCAMP, PRINCIPLES OF ANIMAL COMMUNICATION 711–30 (1998) (employing game theory models to examine different explanations for this phenomenon).

42. Owen D. Jones & Timothy H. Goldsmith, *Law and Behavioral Biology*, 105 COLUM. L. REV. 405, 453–54 (2005).

other enforcement mechanisms, is a fairly recent development. The reluctance to exchange what one possesses in return for something else, so the argument goes, was conducive for survival when exchange was much riskier. Although it is no longer adaptive to modern conditions, it continues to shape people's choices.<sup>43</sup> Other theories aspire to provide psychological and evolutionary explanations for prevailing moral intuitions that differentiate between losses and gains.<sup>44</sup>

*Critique.* PT, including its core notions of reference points and loss aversion, has been the subject of considerable critique. To begin, PT is not the only theory that aims at explaining and predicting people's manifest loss aversion in risky choices. While PT explains loss aversion as resulting from a kink in people's utility function at the reference point and the greater steepness of the utility function in the domain of losses, configural weight theories posit that loss aversion results from the different weight that people attribute to losses and gains, which in turn depends on the perspective from which they judge the choice problem.<sup>45</sup> Configural weight theories and PT are not mutually exclusive, yet they differ in some of their predictions. In any case, they all recognize that people view losses and gains differently and are averse to losses. Hence, for the present purpose, one need not delve into their dissimilarities.

More importantly for our purposes, some studies have challenged the generality of loss aversion. Evidently, different people display varying degrees of loss aversion under different circumstances. Moreover, some studies indicate that loss aversion is neutralized or even reversed for very small amounts of money,<sup>46</sup> and the same is true under certain experimental settings.<sup>47</sup> Some scholars doubt that PT is

---

43. Owen D. Jones & Sarah F. Brosnan, *Law, Biology, and Property: A New Theory of the Endowment Effect*, 49 WM. & MARY L. REV. 1935, 1955–61 (2008).

44. See *infra* notes 220–30 and accompanying text.

45. Michael H. Birnbaum, *New Paradoxes of Risky Decision Making*, 115 PSYCHOL. REV. 463 (2008) (arguing that numerous experimental findings are incompatible with PT yet compatible with configural weight theories); Michael H. Birnbaum & Steven E. Stegner, *Source Credibility in Social Judgment: Bias, Expertise, and the Judge's Point of View*, 37 J. PERSONALITY & SOC. PSYCHOL. 48 (1979) (describing experiments in which subjects who assessed the value of a car based on different estimates placed greater weight on the higher estimate when asked to make the assessment from the seller's perspective and extra weight on the lower estimate when making the assessment from the buyer's perspective).

46. Fieke Harinck et al., *When Gains Loom Larger than Losses: Reversed Loss Aversion for Small Amounts of Money*, 18 PSYCHOL. SCI. 1099 (2007).

47. See, e.g., Eyal Ert & Ido Erev, *The Rejection of Attractive Gambles, Loss Aversion, and the Lemon Avoidance Heuristic*, 29 J. ECON. PSYCHOL. 715 (2008) (describing experiments in

the appropriate explanation for such phenomena as the observed WTA–WTP gap.<sup>48</sup> Yet, the overall picture emerging from hundreds of theoretical, experimental, and empirical studies is clear. People’s preferences, choices, and judgments do generally depend on the perceived reference point and display strong loss aversion.

*Impact on legal theory.* Over the past decades, behavioral studies have profoundly impacted economic, finance, and legal theory. Numerous legal theorists have utilized PT, including its key elements of reference points and loss aversion and the related phenomena of endowment effect and status quo bias, in various legal contexts. Often, commentators used these psychological insights to criticize the explanatory and normative force of standard economic analysis of law.<sup>49</sup> These insights were also relied upon to illuminate human behavior in legal contexts, advise legal actors how to act in interactive legal encounters, and inform legal policymaking.<sup>50</sup> Notable contributions to this body of literature include Jeffrey Rachlinski’s analysis of litigants’ behavior in settlement negotiations,<sup>51</sup> Russell Korobkin’s study of people’s reluctance to contract around default rules due to the status quo bias,<sup>52</sup> and Edward McCaffery’s analysis of hidden taxes and loss aversion.<sup>53</sup>

Without detracting from the great contribution of these and other analyses, the present Article goes one step further. It examines

---

which people tend to reject attractive mixed gambles when asked to decide whether to accept them, but not in choice tasks).

48. See, e.g., Charles R. Plott & Kathryn Zeiler, *The Willingness to Pay—Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530 (2005); Charles R. Plott & Kathryn Zeiler, *Exchange Asymmetries Incorrectly Interpreted as Evidence of Endowment Effect Theory and Prospect Theory?*, 97 AM. ECON. REV. 1449 (2007); see also Thomas C. Brown & Robin Gregory, *Why the WTA-WTP Disparity Matters?*, 28 ECOLOGICAL ECON. 323, 326–29 (1999) (surveying eight different explanations for the WTA-WTP disparity); Russell Korobkin, *The Endowment Effect and Legal Analysis*, 97 NW. U. L. REV. 1227, 1242–55 (2003) (examining various explanations for the endowment effect).

49. See, e.g., Mark Kelman, *Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 52 S. CAL. L. REV. 669, 678–95 (1979) (challenging the validity of the Coase theorem); Korobkin & Ulen, *supra* note 11, at 1102–13 (discussing these challenges to expected utility theory as well as their implications for legal policy).

50. See, e.g., Chris Guthrie, *Prospect Theory, Risk Preference, and the Law*, 97 NW. U. L. REV. 1115, 1120–55 (2003) (surveying legal applications of PT, focusing on people’s different attitudes to gains and losses); Korobkin, *supra* note 48, at 1256–93 (carefully analyzing possible normative implications of the endowment effect in various legal contexts).

51. Jeffrey J. Rachlinski, *Gains, Losses, and the Psychology of Litigation*, 70 S. CAL. L. REV. 113 (1996).

52. Korobkin, *supra* note 36.

53. Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861, 1874–86 (1994).

how the notions of reference points and loss aversion explain fundamental characteristics of entire legal fields and their relative importance.

## II. BASELINES, LOSS AVERSION, AND THE LAW

This Part demonstrates the crucial role that baselines and loss aversion play in various fields of law—private and public, substantive and procedural. The examples include the dissimilar role that tort law and the law of unjust enrichment play in all legal systems (the so-called costs/benefits puzzle); the fundamentally different treatment of takings and givings in constitutional property law; the central role and different statuses of the four interests protected by remedies for breach of contract; and the difference between not hiring and firing in affirmative-action plans. Additional illustrations will be mentioned in Part II.E. Since the explanatory and justificatory power of loss aversion are discussed in detail in Parts III and IV, respectively, this Part will put more emphasis on critically examining alternative explanations and justifications for the various puzzling phenomena.

### *A. Tort Law vs. Unjust Enrichment*

A common feature of all legal systems, including the U.S. system, is the manifest gap between the centrality of the law of tort and the relative marginal status of the law of restitution or unjust enrichment.<sup>54</sup> Interactions in which one person suffers injury or loss due to another person's conduct, without the latter gaining any obvious benefit, give rise to legal entitlements and remedies far more frequently than interactions in which one person receives a considerable benefit thanks to another person's conduct while the latter suffers no significant loss.<sup>55</sup> Even in legal systems that most

---

54. For a comparative analysis of the often residual and limited role of unjust-enrichment claims in various legal systems, see Brice Dickson, *Unjust Enrichment Claims: A Comparative Overview*, 54 CAMBRIDGE L.J. 100 (1995). As regards U.S. law, see, for example, Richard A. Epstein, *The Ubiquity of the Benefit Principle*, 67 S. CAL. L. REV. 1369, 1369–71 (1994) (criticizing the prevailing worldview according to which private law consists of property, torts, and contracts—thus leaving unjust enrichment as a mere component of the law of remedies or as incidental to the major three fields); Wendy J. Gordon, *Of Harms and Benefits: Torts, Restitution, and Intellectual Property*, 21 J. LEGAL STUD. 449, 450 (1992) (“Tort law flourishes, while restitution law remains a virtual backwater . . . .”); Scott Hershovitz, *Two Models of Tort (and Takings)*, 92 VA. L. REV. 1147, 1147 (2006) (“[C]ompared to tort, [restitution] is a trifling part of the law.”).

55. See, e.g., Saul Levmore, *Explaining Restitution*, 71 VA. L. REV. 65, 71 (1985) (pointing to the “anomaly” of the “harms-benefits asymmetry”; namely, that “the legal remedies available to

liberally recognize unjust enrichment as a cause of action, such as Israeli law, recoveries of damages for civil wrongs are overwhelmingly more common than recoveries of restitution for unjust enrichment. Whereas many attorneys describe themselves as “tort lawyers,” practically no one is described as an “unjust-enrichment lawyer.” Relatedly, when the same interaction results in both injury to one side and benefit to the other, the remedial rights of the injured party are usually based on that party’s losses, rather than on the other party’s gains.<sup>56</sup>

This asymmetry has attracted the attention of legal economists.<sup>57</sup> From an efficiency perspective, the railroad company whose trains’ sparks set adjacent fields on fire is no more responsible for the ensuing losses than the farmers who planted their crops next to the railroad. Using spark arresters to eliminate the risk of fire may be described as either avoiding (possibly compensable) harm to the farmers or conferring (possibly recoverable) benefit upon them. The same holds true for the farmers not planting crops next to the railroad.<sup>58</sup> Moreover, even if some activities should be regarded as having negative externalities while others should be regarded as yielding positive ones,<sup>59</sup> to induce efficient behavior the actor should internalize both negative and positive externalities. Yet, the law of tort requires injurers to pay for their negative externalities much more often than the law of unjust enrichment entitles benefactors to regain the benefits that they confer upon others.

Various explanations have been offered for this puzzle. Saul Levmore has argued that in typical tort cases, bargaining between potential injurers and victims (such as road users) is prohibitively costly, whereas such bargaining is often feasible in the context of benefits. Hence, recognizing a right of restitution for nonbargained benefits would discourage the development of a competitive market, as

---

victims of harms are far superior to those enjoyed by analogous providers of nonbargained benefits”).

56. Ofer Grosskopf, *Protection of Competition Rules Via the Law of Restitution*, 79 TEX. L. REV. 1981, 1994–95 (2001). Part II.C below discusses one manifestation of this phenomenon. See also *infra* notes 71, 132, 197 and accompanying text.

57. See, e.g., Donald Wittman, *Liability for Harm or Restitution for Benefit?*, 13 J. LEGAL STUD. 57 (1984); Dari-Mattiacci, *supra* note 6; Levmore, *supra* note 55; Porat, *supra* note 6.

58. Wittman, *supra* note 57, at 58–59; see also Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 2 (1960) (highlighting the reciprocal nature of social costs).

59. See Wittman, *supra* note 57, at 61–73 (proposing to set the baseline with a view to minimizing the administrative costs involved in implementing the system of entitlements and remedies). For a critique of Wittman’s analysis, see Epstein, *supra* note 54, at 1371–76. For additional reasons as to why the law does not entitle people to recover for not harming others, see Gordon, *supra* note 54, at 455–62.

service providers would be able to compel nonconsenting recipients to pay for the benefits, rather than compete with other providers for voluntary transactions.<sup>60</sup>

Another efficiency explanation, offered by Ariel Porat, focuses on the difference between negative and positive externalities in terms of the results of affording the affected people a veto power over the relevant activity. Unlike the previous explanation, this one assumes that bargaining may be unfeasible for both negative and positive externalities. In the case of negative externalities, if an actor had to acquire the consent of every potential injured person before engaging in an activity, then each individual could withhold that consent, thereby thwarting socially desirable activities, such as driving. By protecting people's entitlements through liability rules, tort law concurrently avoids this inefficient result and compels injurers to internalize the cost of their behavior. In the case of positive externalities, the refusal of any beneficiary to pay for the received benefit may also thwart efficient activities whose costs are higher than their benefits to the actor and to the remaining people sharing the costs. However, oftentimes such activities will be carried out despite the refusal of one or more beneficiary to pay for the benefit because enough benefit is produced for those who shoulder the costs. Free riders do not have veto power over beneficial activity.<sup>61</sup> Thus, a general right of restitution for unrequested benefits is considerably less crucial than a right to damages for losses.

Another concern militating against a general right of restitution for unrequested benefits is the valuation difficulties that courts would face were such a right recognized. To be sure, the law of torts faces similar difficulties, but there they are often inevitable (in the absence of feasible voluntary bargaining). In contrast, when it comes to benefits, not only are voluntary transactions often feasible, but there is also a much greater risk of overvaluation. Even if a certain benefit has an ascertainable market value, unless the benefit is monetary, the recipient of the nonbargained benefit may well attribute lower subjective value to it. After all, most people do not purchase most goods and services offered on the market—which means that they value them less than their market price.<sup>62</sup> Yet,

---

60. See Levmore, *supra* note 55, at 79–82 (discussing “market encouragement”); see also Dari-Mattiacci, *supra* note 6, at 24–25, 31–33 (making a similar argument).

61. Porat, *supra* note 6, at 198–205.

62. Gordon, *supra* note 54, at 456–57 (“People cannot afford to buy everything they might like to have, including protection from harm. Being forced to pay for something one would not have purchased is a harm, even if one is required to pay no more than fair market value for it.”);

another efficiency argument against a broader right of restitution focuses on the greater difficulties that a benefactor who has to establish another person's gains faces, as compared to a tort victim who has to prove her own losses.<sup>63</sup>

Other arguments against compelling people to pay for unrequested benefits shift the focus from overall efficiency and administrative costs to the recipient's liberty. Freedom of contract requires not only that people be free to make bargains as they please, but also that they be free from unwanted bargains. This negative aspect of freedom of contract clearly militates against a right of restitution for unrequested benefits.<sup>64</sup> A related explanation is that tort liability is ordinarily imposed for an injurer's active and voluntary behavior, whereas claims based on unrequested benefits usually refer to passive and involuntary recipients.<sup>65</sup>

All of the above arguments are contestable, and none of them provides a complete justification or explanation for the intricacies of the law. For instance, Levmore's assumptions regarding both the feasibility of bargaining between potential benefactors and beneficiaries and the infeasibility of bargaining between potential injurers and victims are questionable: beneficial activities sometimes affect numerous, unidentified people, while harmful activities often adversely affect specific, easily identified ones.<sup>66</sup> Porat's theory, in turn, only explains why the social cost of not recognizing an expansive duty of restitution for unrequested benefits is much smaller than the social cost that would have resulted from not requiring injurers to compensate the nonconsenting injured. Yet, Porat does not explain—and in fact criticizes—the law's unwillingness to adopt a considerably broader right of restitution.<sup>67</sup> The economic justifications for the tort/unjust-enrichment asymmetry may also be criticized for their

---

Levmore, *supra* note 55, at 69–72 (discussing the valuation difficulties). On ways to overcome this problem, see Porat, *supra* note 6, at 209–14.

63. Dari-Mattiacci, *supra* note 6, at 25, 40–42. For a similar argument in the context of contract remedies, see *infra* notes 126–27 and accompanying text. Dari-Mattiacci further proposes an economic rationale for the tort/unjust-enrichment asymmetry based on their dissimilarity in terms of incentives for the parties' activity level. *Id.* at 25, 33–40.

64. Daniel Friedmann, *Unjust Enrichment, Pursuance of Self-Interest, and the Limits of Free Riding*, 36 LOY. L.A. L. REV. 831, 846–47 (2003).

65. Gordon, *supra* note 54, at 465–69; *cf.* Stephen A. Smith, *Justifying the Law of Unjust Enrichment*, 79 TEX. L. REV. 2177, 2183 (2001) (“To avoid liability for unjust enrichment, the ‘activity’ which would have to be given up is life itself.”).

66. See also HANOCH DAGAN, *THE LAW AND ETHICS OF RESTITUTION* 147–48 (2004) (critically discussing Levmore's analysis); Hershovitz, *supra* note 54, at 1150–60 (same).

67. Porat, *supra* note 6, at 190–202, 205–09.

divergence from the prevailing legal reasoning and judicial rhetoric.<sup>68</sup> At the same time, the assertion that the key to the puzzle is the “underlying moral asymmetry” between harms and benefits<sup>69</sup> does not take one very far as long as it is not corroborated by a substantive moral theory.

Be that as it may, my aim here is neither to assess the competing explanations for the tort/unjust-enrichment asymmetry nor to refute them.<sup>70</sup> Rather, at this point I wish to highlight the compatibility between this asymmetry and the asymmetry posited by the notions of baselines and loss aversion. PT posits that losses loom larger than gains and that the status quo ante (the parties’ positions prior to the infliction of the loss or the bestowing of the benefit) is the natural reference point for framing changes as losses or gains. Therefore, a person who suffered a loss due to another person’s behavior is much more likely to seek redress for her loss than a person whose behavior yielded an unrequested benefit for some beneficiary, unaccompanied by a corresponding loss to the benefactor. At least initially, the injured party is likely to view the legal redress as a remedy for her loss. In contrast, the recipient’s refusal to pay for what she received is more likely to be perceived by the benefactor as not obtaining a gain.

Similarly, from the viewpoint of a disinterested arbiter, such as a judge or a legislator, compensating the injured person for her strongly felt loss is likely to be seen as much more pressing than entitling the provider of the nonbargained benefit to recover for the less strongly felt unattained benefit.

In addition to the basic asymmetry between tort and unjust enrichment, loss aversion may plausibly explain other aspects of unjust-enrichment law. For one thing, it seems relevant to cases where unjust enrichment primarily serves as a substitute for a tort action, as the victim’s loss is undeterminable or unverifiable.<sup>71</sup> In fact, some legal systems condition the benefactor’s right to restitution on her incurring a loss, and others view the absence of such a loss as a possible reason to exempt the recipient from the duty of restitution.<sup>72</sup>

---

68. Hershovitz, *supra* note 54, at 1159–60 (“[T]he language of the law is not the language associated with the model of costs.”).

69. *Id.* at 1160.

70. I will, however, flesh out the “moral asymmetry” assertion in *infra* Part III.B.

71. See, e.g., Grosskopf, *supra* note 56, at 1996–2018 (analyzing the advantages of benefit-based remedies for infringements of legal rules that regulate competition without conferring positive entitlements).

72. For the former position, see, for example, KONRAD ZWEIGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW 548 (1998) (explaining that under French law, the first

Loss aversion may possibly explain more specific doctrines of unjust-enrichment law, such as the rescue cases. When a benefactor acts to protect the life, health, or property of a recipient in circumstances where bargaining is not feasible, she is entitled to restitution.<sup>73</sup> The fact that the benefactor protects the recipient from a loss, rather than providing her with a gain, may explain this exception to the general denial of restitution for intentionally conferred, unrequested benefits.

### *B. Constitutional Property Law: Takings vs. Givings*

Under the takings clause of the Fifth Amendment, private property shall not be taken for public use without just compensation.<sup>74</sup> No comparable clause limits the government's power to confer property to private individuals or entities or requires it to charge recipients for such benefits.<sup>75</sup> Not only has nobody proposed to fill this constitutional "gap" by a corresponding "givings clause," quite the opposite is true: there is a prevailing notion that governmental conferring of (even disproportionate) benefits is not objectionable and problematic in the same way as takings.<sup>76</sup>

As a matter of fact, various mechanisms are used in the United States and elsewhere to charge private recipients of property rights and regulatory benefits (such as expansion of building rights by zoning ordinances) for such givings.<sup>77</sup> In practically all legal systems, however, the statutory and judicial safeguards against unjustified or

---

requirement of the general enrichment claim is that the defendant's gain resulted from the plaintiff's impoverishment). For the latter position, see, for example, Unjust Enrichment Law, 5739–1979, SH No. 2192 (Isr.) ("The Court may exempt the beneficiary from the whole or part of the duty of restitution . . . if . . . the receipt of the benefit did not involve a loss to the benefactor . . ."). For the claim that the entire body of unjust-enrichment law "address[es] those gaining practices (and *only* those practices) which are related in one way or another to harm suffered by others," see Kit Barker, *The Nature of Responsibility for Gain: Gain, Harm, and Keeping the Lid on Pandora's Box*, in PHILOSOPHICAL FOUNDATIONS OF THE LAW OF UNJUST ENRICHMENT 146, 152 (Robert Chambers et al. eds., 2009).

73. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT §§ 20, 21 (2011).

74. See generally STEVEN J. EAGLE, REGULATORY TAKINGS 4 (4th ed. 2009); LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 587–613 (2d ed. 1988).

75. The same is true of other constitutions. For a comparative analysis of the constitutional protection of property rights, see GREGORY S. ALEXANDER, THE GLOBAL DEBATE OVER CONSTITUTIONAL PROPERTY: LESSONS FOR AMERICAN TAKINGS JURISPRUDENCE 97–197 (2006).

76. See, e.g., Thomas W. Merrill & Henry E. Smith, *The Morality of Property*, 48 WM. & MARY L. REV. 1849, 1884 (2007) ("Standing alone, the conferring of disproportionate benefits would not give rise to much objection."); *Id.* at 1884 n.151 ("Takings of rights (here property) are regarded as problematic in a way that givings are not.").

77. For a comprehensive comparative survey of such mechanisms, see WINDFALLS FOR WIPEOUTS: LAND VALUE CAPTURE AND COMPENSATION 311–488 (Donald G. Hagman & Dean J. Misczynski eds., 1978).

uncompensated takings are more effective than the safeguards against unjustified or uncharged-for givings, the judicial scrutiny of takings is stricter than that of givings, and the takings scholarship is much more elaborate than that dealing with governmental givings.<sup>78</sup>

Against this backdrop, Abraham Bell and Gideon Parchomovsky have powerfully argued that this disparate treatment of governmental takings and givings is incompatible with the pertinent efficiency, distribution, and fairness considerations. They then offered a conceptual framework for the analysis of givings, parallel to the analysis of takings. Finally, they proposed a detailed set of policy considerations that should underlie the legal regulation of governmental givings and charging of recipients, taking into account such factors as the reversibility of the giving, the identifiability of recipients, and the latter's option to reject the benefit.<sup>79</sup> Subsequent studies employed the concept of givings to analyze various legal issues.<sup>80</sup> These studies, too, criticize the takings/givings distinction and urge a system of charges for governmental givings.

It is perhaps not surprising that neither Bell and Parchomovsky nor their followers have offered much in the way of explanation or justification for the extant legal asymmetry. A close examination of the literature nevertheless reveals some attempts to provide such explanations, while other alleged justifications may be gleaned from the arguments countered by critics of the existing asymmetry.

Apparently, the most obvious explanation is that "losers cry for compensation while winners never cry for taxation."<sup>81</sup> Yet, this explanation is partial at best. There is typically no difference between takings and givings in terms of the number of people who stand to

---

78. See, e.g., Bell & Parchomovsky, *supra* note 7, at 549; Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 554 (1986) (noting that despite the "strong similarity between gains and losses, virtually all investigations of [changes in governmental policy] have ignored the issue of how to treat windfall gains").

79. Bell & Parchomovsky, *supra* note 7. A symmetric economic analysis of governmental takings and givings in the broadest sense of these terms was offered earlier by Louis Kaplow. Kaplow, *supra* note 78. While Bell and Parchomovsky conclude that givings should be charged just as takings are compensated, Kaplow claims that neither one should be compensated/charged. Bell & Parchomovsky, *supra* note 7, at 577–89, 618; Kaplow, *supra* note 78, at 550–60, 615–16.

80. See, e.g., Daniel D. Barnhizer, *Givings Recapture: Funding Public Acquisition of Private Property Interests on the Coasts*, 27 HARV. ENVTL. L. REV. 295 (2003) (exploring the feasibility of using givings-recapture mechanisms to promote effective land use management on coastal floodplains); Lindsay Warren Bowen, Jr., Note, *Givings and the Next Copyright Deferment*, 77 FORDHAM L. REV. 809 (2008) (proposing a givings-based solution to the copyright extension debate).

81. Kaplow, *supra* note 78, at 555.

gain/lose from any governmental action or in terms of the magnitude of such losses/gains. On both sides, the impact of governmental actions may be concentrated or dispersed, large or small.<sup>82</sup> Thus, one could have expected that those who do not receive the benefits would call for taxing or otherwise charging the winners. Moreover, since the government usually needs greater resources for its activities, one could expect it to charge givings as an effective and fair means for raising revenue.<sup>83</sup> Indeed, when benefit recipients are few, the many nonrecipients may encounter difficulties in getting organized to stake their claim for charging recipients.<sup>84</sup> However, this collective action problem does not explain why the framers of the Constitution treated takings and givings so differently, nor does it necessarily explain why the government does not effectively charge recipients of benefits, at least when the latter are not the government's allies or supporters.

Another argument against a "givings clause" is that the Constitution should focus on political power and stability. Since the "foremost danger is that political factions will use the power of the state to eliminate or punish their enemies," it is more important to scrutinize takings.<sup>85</sup> On this logic, laws against corruption and targeted constitutional provisions against self-dealing suffice to address the problem of givings.<sup>86</sup> This argument is hardly persuasive. Whether one assumes, as public choice theory ordinarily does, that political actors are rational maximizers of their own self-interest or adopts a more nuanced portrayal of public officials, one can safely presume that uncharged-for givings pose a potentially greater problem than uncompensated takings. Presumably, political actors are more interested in benefiting themselves and their supporters than in punishing their opponents, and they are more susceptible to effective lobbying by rent-seekers than by people who primarily wish to harm others.<sup>87</sup>

---

82. Lee Anne Fennell, *Taking Eminent Domain Apart*, 2004 MICH. ST. L. REV. 957, 967–71.

83. Cf. Kaplow, *supra* note 78, at 555–56 (discussing compensation for losses (takings) and taxations for gains (givings) from the government's perspective).

84. The seminal study of the collective action problem is MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1965). On the importance of group size, see *id.* at 53–65.

85. Henry A. Span, *Public Choice Theory and the Political Utility of the Takings Clause*, 40 IDAHO L. REV. 11, 99 (2003).

86. *Id.* (concluding that the problem of givings is not sufficiently related to political power and stability to merit treatment by the Constitution).

87. See Bell & Parchomovsky, *supra* note 7, at 553, 593–96 (discussing rent-seeking in the political process); Reza Dibadj, *Regulatory Givings and the Anticommons*, 64 OHIO ST. L.J. 1041, 1063–73 (2003) (describing the tenets of public choice theory and its critique); see also Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON.

Similarly problematic is the claim that limitations on uncharged-for givings are more difficult to delineate than those on uncompensated takings.<sup>88</sup> As Bell and Parchomovsky have demonstrated, there is considerable resemblance between the challenges facing both tasks, and comparable criteria may be used in both contexts.<sup>89</sup>

Considerations of efficiency and fairness also seem to militate against the takings/givings asymmetry. From an efficiency standpoint, the government should internalize both the costs and benefits of its activities so as to avoid the inefficiencies associated with negative and positive externalities.<sup>90</sup> From a fairness perspective, it is unfair that a few people will be enriched at the expense of the public at large, just as it is unfair that a few people will be required to bear the public burden.<sup>91</sup>

All of this makes the current asymmetry all the more mysterious.<sup>92</sup> Or does it? Henry Span has argued in this context that “the endowment effect and the declining marginal utility of wealth suggest that protecting what one has is a stronger incentive for transgressing the bounds of democratic politics than is acquiring new wealth.”<sup>93</sup> While one may question the seriousness of the risk of landowners transgressing the limits of democracy and doubt that diminishing marginal utility can account for the different ways people perceive gains and losses, Span seems to be on the right track in alluding to the endowment effect. Assuming that people ordinarily view the status quo as the pertinent benchmark, when the government takes their property or otherwise adversely affects its value, such taking is rather painful and causes considerable resentment. In contrast, when the government benefits other people, it is more likely to be perceived as an unobtained gain, rather than as a loss, or to be disregarded altogether. Hence, it is considerably less painful and a lesser cause of resentment.

As in other contexts, the distinction is not hermetic. If the thing taken is something that was previously given by the

---

371 (1983) (formulating a general theory of rent-seeking by pressure groups in the political arena).

88. Span, *supra* note 85, at 99.

89. Bell & Parchomovsky, *supra* note 7, at 590–608.

90. *Id.* at 580–84.

91. *Id.* at 554.

92. The assertion that “[t]akings infringe the property rights of owners [while] [g]ivings . . . do not, by their nature, infringe anyone’s rights,” Hershovitz, *supra* note 54, at 1186, hardly resolves the mystery, at least as long as it is not corroborated by a substantive moral theory. See *supra* text accompanying note 69. Hershovitz offers no such theory.

93. Span, *supra* note 85, at 99 (references omitted).

government, one may perhaps view it as belonging in the domain of (avoided) gains. If everyone but me gets something, I may view the position of everyone else as the reference point—and experience my not receiving it as a loss. The smaller the number of other people who get the benefit and the greater the distance and dissimilarity between the agent and the recipients, the less one would expect such a shift of reference point. Interestingly, the issue of the pertinent baseline is a recurring theme in takings and givings debates.<sup>94</sup> Nevertheless, the salience of the status quo as the natural reference point seems to provide the best explanation for the takings/givings asymmetry.<sup>95</sup>

*C. Remedies for Breach of Contract: Reliance, Expectation, Restitution, and Disgorgement*

In the past decades, the analysis of contract remedies has been dominated by Lon Fuller and William Perdue's classification of the "interests" protected by remedies for breach of contract: expectation, reliance, and restitution.<sup>96</sup> As ordinarily conceived, the expectation interest focuses on the injured party and is forward-looking in the sense that it aims at putting her in the same position that she would have been in had the contract been fully performed. The reliance interest also focuses on the injured party, yet it is backward-looking in the sense that it strives to put her in the position that she would have been in had she not made the contract in the first place. The restitution interest, on the other hand, focuses on the breaching party. It is backward-looking in that it aims to put the breaching party in a position similar to the one that she would have been in had no

---

94. See, e.g., TRIBE, *supra* note 74, at 607–09 (discussing the pertinent baseline concept); Bell & Parchomovsky, *supra* note 7, at 552, 612–14 (discussing baselines for givings and takings); Cass R. Sunstein, *Lochner's Legacy*, 87 COLUM. L. REV. 873 (1987) (analyzing and questioning the implicit assumptions regarding the baseline against which the constitutionality of governmental actions, including takings, should be assessed). A more specific context in which the pertinent baseline has been recurrently debated is the distinction between harm-preventing and benefit-conferring regulation, used to delineate the scope of the takings clause. See, e.g., *Lucas v. S.C. Coastal Council*, 505 U.S. 1003 (1992). See generally *supra* note 24; *infra* notes 248, 264 and accompanying text.

95. Another puzzling characteristic of the law of takings that may be explained through the notion of loss aversion is the considerably stronger protection afforded to existing uses, compared to future ones. See Christopher Serkin, *Existing Uses and the Limits of Land Use Regulations*, 84 N.Y.U. L. REV. 1222, 1267–70 (2009) (mentioning loss aversion as a possible explanation for this phenomenon, yet finding it on the whole indefensible); Jeffrey Evans Stake, *Loss Aversion and Involuntary Transfers of Title*, in LAW AND ECONOMICS: NEW AND CRITICAL PERSPECTIVES 331, 341–46 (Robin Paul Malloy & Christopher K. Braun eds., 1995) (discussing Supreme Court's treatment of takings that induce future losses).

96. L. L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages* (pt. 1), 46 YALE L.J. 52, 54 (1936).

contract been made. Forcing the party in breach to return the benefits that she obtained from the injured party attains this goal.<sup>97</sup>

This classification is analytically incomplete since it disregards the possibility of remedies designed to put the breaching party in the position that she would have been in had she performed the contract. This goal typically can be achieved by disgorging the breaching party of any benefit that she gained by breaching the contract, even if that benefit was not drawn from anything that she received from the injured party. It is thus conventionally labeled the disgorgement interest.<sup>98</sup> The following table highlights the basic characteristics of the four interests<sup>99</sup>:

**TABLE 1. THE FOUR INTERESTS**

|                  | Injured Party | Breaching Party |
|------------------|---------------|-----------------|
| Backward-looking | Reliance      | Restitution     |
| Forward-looking  | Expectation   | Disgorgement    |

The prevailing convention is that the law primarily protects the injured party's expectation interest.<sup>100</sup> This is sometimes done by awarding specific performance but more often through damages. The reliance measure of damages is sometimes used instrumentally as a minimal approximation of the injured party's expectation interest when the latter is unverifiable.<sup>101</sup> Under some circumstances, the injured party may opt for remedies protecting her restitution

---

97. For a more detailed exposition of the three interests, see 24 RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS BY SAMUEL WILLISTON 20–44 (Danny R. Veilleux ed., Thomson West 4th ed. 2002).

98. On this interest, see ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 257–58 (5th ed. 2008) (discussing the incentives created by disgorgement); JAMES EDELMAN, GAIN-BASED DAMAGES: CONTRACT, TORT, EQUITY AND INTELLECTUAL PROPERTY 149–89 (2002) (comprehensively analyzing the issue from comparative and normative perspectives); Melvin A. Eisenberg, *The Disgorgement Interest in Contract Law*, 105 MICH. L. REV. 559 (2006) (arguing that contract law should and to some extent does protect the disgorgement interest); Ernest J. Weinrib, *Punishment and Disgorgement as Contract Remedies*, 78 CHI.-KENT L. REV. 55, 70–84 (2003) (critically analyzing disgorgement remedies from the standpoint of corrective justice).

99. Cf. Avery Katz, *Reflections on Fuller and Perdue's The Reliance Interest in Contract Damages: A Positive Economic Framework*, 21 MICH. J.L. REFORM 541, 545 (1988).

100. 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS, 149–50, 190 (3d ed. 2004); LORD, *supra* note 97, at 20–30; G.H. TREITEL, REMEDIES FOR BREACH OF CONTRACT: A COMPARATIVE ACCOUNT 82–83 (1988).

101. Reliance damages are also awarded when the cause of action is not truly contractual, but rather tort or tort-like, as in some cases of promissory estoppel. FARNSWORTH, *supra* note 100, at 279–88.

interest.<sup>102</sup> In contrast, disgorgement remedies are not ordinarily available for breach of contract.<sup>103</sup>

On the normative level, there is an ongoing debate as to which interests are most worthy of protection. Some argue that contract remedies should primarily or even exclusively protect the promisee's expectation interest,<sup>104</sup> while others claim that the law should (and does) content itself with protecting reliance and restitution.<sup>105</sup> Interestingly, none of the major theories of contract law, such as the will theory, economic efficiency, and corrective justice, unequivocally supports any of the interests.<sup>106</sup>

For the present purpose, I would like to focus, first, on the structuring of the doctrine and the normative debate around the interests described above and, second, on the marginality of the disgorgement interest. Regarding the first issue, Richard Craswell has powerfully argued that Fuller and Perdue's tripartite classification (as well as, impliedly, the quadripartite classification described above) should be abandoned. Whether one's perspective on contract remedies is instrumental (such as the economic approach) or noninstrumental (such as the liberal theory of contract as promise), "there is no reason to think that the remedy that best serves the chosen substantive goal

---

102. See generally 3 DAN B. DOBBS, DOBBS LAW OF REMEDIES 159–70, 178–89 (1993); FARNSWORTH, *supra* note 100, at 323–38; Eyal Zamir, *The Missing Interest: Restoration of the Contractual Equivalence*, 93 VA. L. REV. 59, 79–85 (2007).

103. DOBBS, *supra* note 102, at 1170–78; EDELMAN, *supra* note 98; FARNSWORTH, *supra* note 100, at 338–83; see also RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 39 (2011) (proposing to extend the availability of disgorgement as a remedy for opportunistic breach); Eisenberg, *supra* note 98, at 565–66, 578–98 (arguing that the disgorgement interest is actually protected more than it is usually realized). Israeli law is exceptional in this regard. See F.H. 20/82 Adras Bldg. Material Ltd. v. Harlow & Jones GmbH, 42(1) PD 221 (1988), *translated in Law Report*, RESTITUTION L. REV., Autumn 1995, at 235 (1995) (holding that plaintiff is entitled to recover all profits gained by the defendant as a result of contract breach); Hanoch Dagan, *Restitutionary Damages for Breach of Contract: An Exercise in Private Law Theory*, 1 THEORETICAL INQ. L. 115 (2000) (critically discussing the *Adras* case). However, even in Israel, while the disgorgement interest is in principle protected in breach-of-contract cases, disgorgement remedies are hardly ever sought or awarded.

104. See, e.g., CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 17–27 (1981) (grounding this claim in a theory of contract as promise); Andrew S. Gold, *Contract as Property*, 103 NW. U. L. REV. 1, 46 (2009) (basing expectation remedies on a theory of contract as transfer of ownership in the promisor's future actions); Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417, 1503–14 (2004) (basing this argument on a theory of contract as collaboration); Steven Shavell, *Damages Measures for Breach of Contract*, 11 BELL J. ECON. 466 (1980) (favoring expectation damages from an economic efficiency perspective).

105. P.S. ATIYAH, CONTRACT, PROMISES, AND LAW (1981) (developing a theory of contractual liability based on restitution and reliance); Fuller & Perdue, *supra* note 96, at 53–66 (advocating the reliance measure of damages on the basis of notions of corrective justice).

106. EYAL ZAMIR & BARAK MEDINA, LAW, ECONOMICS, AND MORALITY 294–301, 305–10 (2010); Craswell, *supra* note 8, at 106–36.

will necessarily coincide with one of Fuller and Perdue's three 'interests.'"<sup>107</sup> In fact, claims Craswell, both instrumental and noninstrumental theories may endorse a measure of damages that would lie anywhere on the real number line.<sup>108</sup> He then argues that the common classification is not even helpful as a descriptive framework. Sometimes, courts award remedies that do not fit neatly into any of the recognized interests.<sup>109</sup> At the same time, judgments that purportedly aim to protect the same interest often provide the injured party with such markedly dissimilar remedies that grouping them under the same category is almost meaningless.<sup>110</sup>

And yet, a decade later, courts, scholars, and legal educators keep referring to the different interests as useful organizing principles of contract remedies. This continued resort to the conventional classification may be due to flaws in Craswell's analysis.<sup>111</sup> However, there seems to be a more fundamental reason. As Craswell concedes, legal reasoning cannot function without some points of reference. Neither making a very long list of all conceivable remedies without any organizing principle nor authorizing the courts to choose the most appropriate measure of damages in each and every case based on all pertinent policy considerations are viable options for the law.<sup>112</sup> PT teaches us that meaningful baselines are essential to people's assessments and decisions, and legal decisions are no exception. Thus, Craswell might be right in arguing that from an efficiency standpoint or some other normative perspective, the optimal measure of damages, all things considered, may be, say, "[sixty-three] percent of expectation interest."<sup>113</sup> Yet, at least psychologically, he is wrong in arguing that aiming at one hundred percent of the expectation (or any other) measure "is no less arbitrary" than aiming at the sixty-three percent of expectation measure of damages. Contrary to sixty-three percent of

---

107. Craswell, *supra* note 8, at 107.

108. *Id.* at 110, 114, 116; cf. Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 489 (1989) (arguing that promise-based theories of contract law "have little or no relevance to those parts of contract law that govern the proper remedies for breach").

109. See also Zamir, *supra* note 102 (identifying restoration of the contractual equivalence as a fifth goal of contract remedies).

110. Craswell, *supra* note 8, at 136–54.

111. For recent counterarguments, see, for example, DORI KIMEL, FROM PROMISE TO CONTRACT: TOWARDS A LIBERAL THEORY OF CONTRACT 89–100 (2003); Markovits, *supra* note 104, at 1491–514.

112. Craswell, *supra* note 8, at 155–56.

113. *Id.* at 111, 117.

whatever interest, one hundred percent is a natural focal point.<sup>114</sup> Thus, it is much more likely to serve as a reference point.

Having recognized the importance of reference points, I now turn to the marginal status of the disgorgement interest. The notion of loss aversion is helpful here, too. From the perspective of PT, both expectation and reliance are conceivable points of reference for assessing an injured party's losses due to a breach.<sup>115</sup> While Fuller and Perdue viewed the injured party's position prior to contracting as the natural baseline,<sup>116</sup> this perception is not at all self-evident.<sup>117</sup> Just as naturally, one may view the outcomes of breach as a deviation from the injured party's position had the contract been performed.<sup>118</sup> For example, when a seller delivers defective goods or does not deliver goods on time, the reference point may well be the buyer's position had she received conforming goods on time. Even when making a contract entails no opportunity costs (that is, one would not have pursued an alternative course of action had she not made the contract) and before anything is performed under the contract, repudiation by the other party ordinarily causes disappointment and displeasure. Making a promise or a contract, and then breaking it, is more deleterious than not making the promise or the contract in the first place, even absent any reliance or enrichment. A promise/contract creates expectations of performance. It changes the promisee's point of reference so that

---

114. The notion of focal points was introduced in THOMAS C. SCHELLING, *THE STRATEGY OF CONFLICT* (1960). While Schelling's primary concern was coordination without communication, he also discussed the role of focal points in explicit bargaining, *id.* at 67–74. For a brief summary of game theory studies of focal points, see Maarten C.W. Janssen, *Focal Points*, in 2 *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 150 (Peter Newman ed., 1998).

115. See *supra* notes 21–22 and accompanying text.

116. See Fuller & Perdue, *supra* note 96, at 54 (“[T]he plaintiff has in reliance on the promise of the defendant changed his position . . . . Our object is to put him in as good a position as he was in before the promise was made.”).

117. The same questionable perception also characterizes Cohen and Knetsch's more recent analysis. See Cohen & Knetsch, *supra* note 5, at 753–56 (“While lost profits are said to be recoverable in contract law, it is difficult to defend the proposition that the *expectation* interest of a non-breaching party is recognized in contract actions in the same fashion as are *actual* losses.”).

118. See, e.g., Craswell, *supra* note 8, at 125–27; Zamir, *supra* note 102, at 108–10. Fuller and Perdue actually recognized this when asserting that there is a “psychological” explanation for why the law protects the expectation interest: “Whether or not he has actually changed his position because of the promise, the promisee has formed an attitude of expectancy such that a breach of the promise causes him to feel that he has been ‘deprived’ of something which was ‘his.’” Fuller & Perdue, *supra* note 96, at 57. For justifications of the expectation measure of damages resting on notions of corrective justice, see, for example, Peter Benson, *The Unity of Contract Law*, in *THE THEORY OF CONTRACT LAW: NEW ESSAYS* 118, 127–38 (Peter Benson ed., 2001); Daniel Friedmann, *The Efficient Breach Fallacy*, 18 *J. LEGAL STUD.* 1, 13–18 (1989); Weinrib, *supra* note 98, at 62–70.

nonperformance is more likely to be perceived as a loss, rather than merely as an unobtained gain.<sup>119</sup>

As for the disgorgement interest, while there is a relatively broad consensus regarding the general unavailability of the disgorgement relief, the soundness of this position is hotly debated. From an economic point of view, a disgorgement remedy would arguably eliminate the incentive for an efficient breach and is thus undesirable.<sup>120</sup> But this conclusion is too hasty. Even if the third party is unlikely to approach the buyer, the seller may still negotiate a discharge of the original contract with the buyer, thus facilitating its efficient nonperformance. Granted, such negotiation may be costly due to the bilateral monopoly situation.<sup>121</sup> However, the cost of resolving a dispute resulting from a breach of contract and of judicially determining the damages for the breach is likely to be higher.<sup>122</sup> Entitling the injured party to disgorgement remedies need not thwart an efficient breach for yet another reason. As Richard Brooks has pointed out, one way to incentivize the promisor to efficiently perform or breach is by affording the promisee a choice between performance and disgorgement.<sup>123</sup>

Deontological moral theories are all the more likely to endorse disgorgement, thereby expressively and practically strengthening the notion that a promisor should keep her promises.<sup>124</sup> This claim, too,

---

119. Cf. Fredrick E. Vars, *Attitudes Toward Affirmative Action: Paradox or Paradigm?*, in RACE VERSUS CLASS: THE NEW AFFIRMATIVE ACTION DEBATE 73, 82–89 (Carol M. Swain ed., 1996) (describing an experiment indicating that while giving a benefit that was promised to some people to others is less objectionable than taking such a benefit from people who already received it and giving it to others, it is considerably more objectionable than giving priority to some people over others in allocating a benefit and than allocating a benefit to some people only, rather than to others). For psychological studies establishing that expectations are likely to affect people's reference points, see *supra* note 22 and accompanying text.

120. See, e.g., Sidney W. DeLong, *The Efficiency of Disgorgement as a Remedy for Breach of Contract*, 22 IND. L. REV. 737, 742–45 (1989).

121. *Id.* at 744–45.

122. William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 DUKE L.J. 629, 634 (1999) (contending that “the transaction costs of negotiating a release are typically lower than the assessment costs of establishing damages at trial”); Friedmann, *supra* note 118, at 6–7 (asserting that negotiating a dispute is hardly costless, but any resulting litigation could be extremely expensive).

123. Richard R.W. Brooks, *The Efficient Performance Hypothesis*, 116 YALE L.J. 568 (2006). For a powerful refutation of the claim that disgorgement is inefficient, see Eisenberg, *supra* note 98, at 570–78.

124. Adras, *supra* note 103, at 241 (Judge S. Levin explaining that Israeli law's perception of contract breach as wrongdoing is incompatible with an economic analysis of law); *id.* at 272 (rejecting the notion of efficient breach, Judge Barak proclaims: “Promise keeping is the basis of our life, as a society and a nation.”); Eisenberg, *supra* note 98, at 578–81; Daniel Friedmann, *Restitution of Benefits Obtained through the Appropriation of Property or the Commission of a Wrong*, 80 COLUM. L. REV. 504, 515 (1980) (“[L]imitation of a plaintiff's remedy to damages tends

may, however, be challenged. If contracting parties typically prefer that under such circumstances the seller would be free to breach the contract subject to the payment of expectation damages, then even deontological theories need not object to a default rule denying the buyer's entitlement to disgorgement.<sup>125</sup>

A second-order consideration against disgorgement remedies lies in the difficulty of enforcing them. The injured party usually possesses the information and evidence necessary to establish her profits had the contract been performed (expectation) and her monetary position had she not made the contract (reliance). The facts necessary to establish one's restitution interest are also quite observable and verifiable because the injured party knows what she gave the breacher. In contrast, when the injured party sues for disgorgement, her claim typically refers to the extra profits that the breacher made, or the losses she cut, by breaching the contract—and this information may be unknown to the injured party.<sup>126</sup> Consequently, so the argument goes, disgorgement remedies are not something that promisees would ordinarily be willing to pay for *ex ante*.<sup>127</sup>

This argument is not conclusive. Even when the injured party sues for her expectation or reliance losses, she has to establish that these losses were foreseeable from the breacher's perspective at the time of contracting.<sup>128</sup> If the injured party's losses are observable from the breacher's point of view (and were so all along), it is unclear why the breacher's gains from the breach should necessarily be unobservable from the injured party's perspective.<sup>129</sup> Moreover, while

---

to trivialize the importance of contractual obligations . . ."); *see also* Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708 (2007) (arguing that by limiting the injured party's remedies to expectation damages, contract law does not accommodate the needs of moral agency).

125. For a deontological objection to disgorgement as a standard remedy for breach, see, for example, Weinrib, *supra* note 98. *See also* Dagan, *supra* note 103, at 118–25 (arguing that the inherent value of promise keeping is neutral to the desirability of disgorgement remedies).

126. FARNSWORTH, *supra* note 100, at 342–43; *cf.* Gideon Parchomovsky & Alex Stein, *Reconceptualizing Trespass*, 103 NW. U. L. REV. 1823, 1845 (2009) (discussing the same concern in the context of remedies for trespass).

127. Dagan, *supra* note 103, at 142–46.

128. *See* FARNSWORTH, *supra* note 100, at 255–68 (discussing unforeseeability as a limitation on assessments of damages); TREITEL, *supra* note 100, at 150–62 (discussing foreseeability).

129. Arguably, an injured party entitled to disgorgement remedies would also be entitled to pretrial discovery rights that would imperil the breacher's secrecy interest—a prospect that may affect the desirability of these remedies. *Cf.* Omri Ben-Shahar & Lisa Bernstein, *The Secrecy Interest in Contract Law*, 109 YALE L.J. 1885 (2000) (discussing this interest in the complementary case of expectation damages). However, the fact that the law imposes disgorgement remedies against trustees implies that these difficulties are not insurmountable. *See infra* note 133 and accompanying text.

the alleged difficulty to enforce the disgorgement remedy decreases the promisee's willingness to pay for it *ex ante*, it concomitantly decreases what the promisor would ask for it, knowing that this remedy is unlikely to be enforced against her. Hence, an agreement is feasible.

This succinct description of the debate suffices to demonstrate that the justifications thus far proposed for the marginality of disgorgement remedies are, to say the least, contestable.<sup>130</sup> Melvin Eisenberg, who advocates broader recognition of disgorgement remedies, considers several explanations for the rarity of cases in which such remedies are actually sought and awarded.<sup>131</sup> Among other things, the injured party's loss is often greater than the breacher's gain and hence expectation damages are more attractive. At other times, the injured party is entitled to specific performance, thereby preventing the promisor from making a gain through breach. However, these arguments do not fully explain extant law. Breaches in which the breacher's observable and verifiable gains are greater than the injured party's verifiable losses are probably much more common than reflected in the case law. Similarly, specific performance is often unobtainable, and even when it is available, disgorgement remedies may be superior. This would be the case, for example, where the opportunity to make the extra profit is only available to the promisor, and the costs of renegotiation are prohibitive.

Here too, the notion of loss aversion provides a crucial insight. If, as is very plausibly the case, promisees do not ordinarily view promisors' profits (including avoided losses) from the breach as something that they have lost, then not getting these profits is considerably less painful than not getting back what they gave the breacher (restitution), the costs they incurred in performing the contract (reliance), and their own losses due to the breach (expectation). Consequently, disgorgement remedies are much less likely to be sought, and legal decisionmakers are much less likely to award them.<sup>132</sup>

---

130. See also E. Allan Farnsworth, *Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract*, 94 YALE L.J. 1339, 1343–50 (1985) (providing causation arguments against protecting the disgorgement interest); Eisenberg, *supra* note 98, at 566–70 (critiquing the causation arguments).

131. Eisenberg, *supra* note 98, at 597–99.

132. Breach of contract is not the only context in which an injured person's loss is often accompanied by a gain to the injurer and in which legal relief is much more often based on the injured's loss than on the injurer's gain. See Grosskopf, *supra* note 56, at 1994–95 (“The protection of entitlements is as old as the law itself. . . . One of the prominent products of this extensive legal discourse is the preference for harm-based remedies over benefit-based remedies, as far as protecting entitlements is concerned.”); *supra* notes 56, 71 and accompanying text.

More speculatively, the losses/gains distinction may help to explain why disgorgement remedies, which are not ordinarily available for breach of contract, are available against a trustee or a fiduciary that breached her duty of loyalty.<sup>133</sup> Since the trust property is legally and conventionally perceived as something that the beneficiary already has, if only in equity, rather than as something she is entitled to receive from the trustee, both beneficiaries and legal decisionmakers are more likely to view the illicit profits made by the trustee as belonging to the domain of the beneficiary's losses, rather than to the realm of her unobtained gains. Following the same logic, it is unsurprising that the greatest supporters of disgorgement remedies for breach of contract also adhere to the theory of contractual rights as akin to property rights.<sup>134</sup> If one views the formation of a contract as akin to an instantaneous transfer of property-like entitlements, then—as in the case of trust—it is natural to view the breacher's gains from appropriating these entitlements as depriving the promisee of something that she already had.

#### *D. Civil-Rights Law: Affirmative Action*

Affirmative action is taking positive steps to increase the representation of minorities and women in the workplace, in education, and in other areas from which they have historically been excluded.<sup>135</sup> Affirmative action is politically, morally, and legally controversial.<sup>136</sup> An interesting aspect of the debate has to do with its

---

133. RESTATEMENT (SECOND) OF TRUSTS § 206, cmt. a (1959); FARNSWORTH, *supra* note 100, at 344–52 (discussing the roots of the disgorgement principle in the fiduciary context); J.C. SHEPHERD, *THE LAW OF FIDUCIARIES* 116–19 (1981); Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 829 (1983) (illustrating the principle by describing breaches by a corporate agent and a CIA agent).

134. See Friedmann, *supra* note 124, at 515 & n.54 (arguing that the issue underlying the debate over disgorgement remedies is whether “the promisee [is] ‘entitled’ to [the contractual performance] in such a way that if this performance is withheld, appropriated, or otherwise ‘taken,’ the promisee can be regarded as having been deprived of an interest that ‘belonged’ to him”; and adding that “[t]here is substantial support for the view that contractual rights are a form of property”); Friedmann, *supra* note 118, at 4 (equating efficient breach with “efficient theft”); see also Eisenberg, *supra* note 98, at 579 (citing Friedmann approvingly).

135. E.g., Robert Fullinwider, *Affirmative Action*, in STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., 2011), available at <http://plato.stanford.edu/entries/affirmative-action>; Faye J. Crosby & Diana I. Cordova, *Words Worth of Wisdom: Toward an Understanding of Affirmative Action*, in SEX, RACE, AND MERIT: DEBATING AFFIRMATIVE ACTION IN EDUCATION AND EMPLOYMENT 13 (Faye J. Crosby & Cheryl VanDeVeer eds., 2000) (discussing different meanings of the term). For a general survey of affirmative-action law, see 2 BARBARA T. LINDEMANN & PAUL GROSSMAN, *EMPLOYMENT DISCRIMINATION LAW* 2483–702 (4th ed. 2007).

136. See generally SEX, RACE, AND MERIT, *supra* note 135; Jerry Kang & Mahzarin R. Banaji, *Fair Measures: A Behavioral Realist Revision of “Affirmative Action”*, 94 CALIF. L. REV. 1063,

framing. Affirmative action plans are ordinarily conceived as benefiting some people while adversely affecting others (those who would have received the benefit absent the affirmative-action policy). Advocates of these plans argue, however, that they do not inflict losses on nonminority people but rather reduce the unjust enrichment of the majority due to prior discriminatory practices.<sup>137</sup> Tellingly, this argument seeks to reduce the objection to affirmative action by framing its effects on the nonminority group as belonging to the realm of gains, thus making these policies less painful.

Rather than delving into the doctrinal complexity of affirmative action or the heated normative debate it has generated, I wish to spotlight one feature that is noticeably uncontroversial. A common denominator of practically all affirmative-action policies is that they refer to benefits that people do not yet have. When affirmative-action policies are instituted at a university or in the workplace, they mandate that one person rather than another will gain admission or secure a job. They very rarely, if ever, dictate that an employee who already occupies a certain position, or who has been legitimately appointed to it, should vacate her position for another.<sup>138</sup> The same holds true for students who already attend a university or have been admitted, as well as in contexts such as governmental procurements. This feature of affirmative action is equally

---

1064 (2006) (“Since its inception in the 1960s, affirmative action has produced volumes of moral, legal, and policy arguments both to justify and undermine its very existence.”) (citation omitted); Randall Kennedy, *Persuasion and Distrust: A Comment on the Affirmative Action Debate*, 99 HARV. L. REV. 1327, 1327 (1986) (describing the controversy over affirmative action as “the most salient current battlefield in the ongoing conflict” over race relations); Jed Rubenfeld, *Affirmative Action*, 107 YALE L.J. 427 (1997); Peter H. Schuck, *Affirmative Action: Past, Present and Future*, 20 YALE L. & POLY REV. 1, 2 (2002) (“Affirmative action policy is even more divisive and unsettled today than at its inception thirty years ago.”).

137. See, e.g., *Fullilove v. Klutznick*, 448 U.S. 448, 484–85 (1980) (Burger, C.J.) (plurality opinion) (“Moreover, although we may assume that the complaining parties are innocent of any discriminatory conduct, it was within congressional power to act on the assumption that in the past some nonminority businesses may have reaped competitive benefit over the years from the virtual exclusion of minority firms from these contracting opportunities.”); accord *Ohio Contractors Ass’n v. Keip*, 713 F.2d 167, 173 (6th Cir. 1983) (citing *Fullilove* approvingly); Ian Ayres & Fredrick E. Vars, *When does Private Discrimination Justify Public Affirmative Action?*, 98 COLUM. L. REV. 1577, 1616–19 (1998) (discussing the “unjust enrichment principle”).

138. See, e.g., *Local 28 of the Sheet Metal Workers’ Int’l Ass’n v. EEOC*, 478 U.S. 421, 479 (1986) (Brennan, J.) (plurality opinion) (upholding an affirmative-action plan in part because it “did not require any member of the union to be laid off, and did not discriminate against existing union members”); *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 549 (1989) (Marshall, J., dissenting) (“[L]ike the federal provision, Richmond’s does not interfere with any vested right of a contractor to a particular contract; instead it operates entirely prospectively. Richmond’s initiative affects only future economic arrangements . . . .” (citation omitted)).

characteristic of legal systems where affirmative action is less controversial.<sup>139</sup>

Arguably, the difference between affirmative action in hiring and in layoffs is that the former will “impose a diffuse burden,” while the latter will “impose the entire burden of achieving racial equality on particular individuals.”<sup>140</sup> While intuitively and psychologically sensible,<sup>141</sup> this argument is not without its problems. The difficulty lies in the fact that, at the end of the day, there is one particular nonminority person who would have been hired had the affirmative-action policy not been in effect.<sup>142</sup> Loss aversion plausibly provides a better explanation. Adversely affecting people by not giving them something, such as the opportunity to study at a certain institution, is considerably less painful than taking an entitlement away.<sup>143</sup> This perception prevails regardless of whether taking the entitlement from those who already have it entails greater transaction costs or any additional losses, such as investments in job-specific skills and

---

139. See, e.g., State Service (Appointments) Law § 15A(b), (c), 5719-1959, 13 LSI 87 (1959) (Isr.), available at <http://ilo-mirror.library.cornell.edu/public/english/employment/gems/eo/law/israel/ssl.htm> (instructing the government to employ affirmative-action plans for the recruitment and promotion of women, people with disabilities, Arabs, and immigrants from Ethiopia); Equal Rights for People with Disabilities Law § 9(b), 5758-1998, S.H. No. 1658 p. 152 (Isr.) (providing for affirmative action in the hiring and promotion of people with disabilities); ANNE PETERS, WOMEN, QUOTAS, AND CONSTITUTIONS 129-36 (1999) (surveying affirmative-action statutes referring to women in Germany).

140. *Wygant v. Jackson Bd. of Educ.*, 476 U.S. 267, 283 (1986) (Powell, J.) (plurality opinion); see also *City of Richmond*, 488 U.S. at 549 (“The plurality in *Wygant* emphasized the importance of not disrupting the settled and legitimate expectations of innocent parties.”); Vars, *supra* note 119, at 79 (noting that a policy that generates clear losses for an identifiable group of people is perceived as more objectionable than a policy that does not generate such losses).

141. Cf. Tehila Kogut & Ilana Ritov, *The Singularity Effect of Identified Victims in Separate and Joint Evaluations*, 97 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 106 (2005) (surveying the literature on and providing experimental support for the greater willingness to help identified victims relative to nonidentified ones). Relatedly, from the victim’s perspective, it obviously matters whether she is aware of the fact that she was the one who would have gotten the benefit.

142. Cf. Richard Primus, *The Future of Disparate Impact*, 108 MICH. L. REV. 1341, 1369-74 (2010) (discussing the pros and cons of considering the visibility-of-victims factor in assessing the constitutionality of race-conscious interventions).

143. Vars, *supra* note 119 (basing this claim on general psychological insights and the findings of a specifically designed survey); see also *Johnson v. Transp. Agency, Santa Clara Cnty.*, 480 U.S. 616, 638 (1987) (affirming a decision to promote a woman rather than a man, the court noted that “denial of the promotion unsettled no legitimate, firmly rooted expectation on the part of [the] petitioner. [The] petitioner . . . retained his employment with the Agency, at the same salary and with the same seniority, and remained eligible for other promotions.”); Ayres & Vars, *supra* note 137, at 1617 n.139 (relying on the notion of loss aversion to support the claim that “[t]he burden on nonbeneficiaries of an affirmative action plan in contracting may be perceived by the Court to be relatively light if it does not interfere with settled, legitimate expectations”).

personal relationships.<sup>144</sup> It may also make the beneficiaries of affirmative action feel more comfortable with these plans.

From the perspective of loss aversion, the most difficult cases are those in which it is unclear whether the implementation of an affirmative-action policy deprives nonminority persons of an entitlement that they can reasonably perceive as something they already have or merely allocates an as-yet-unallocated benefit to members of the minority group. In *Cortez III Service Corp. v. NASA*, a contractor who provided services to a federal agency for ten years under two consecutive contracts was ineligible to compete for a third contract because it did not meet the newly applied affirmative-action criteria.<sup>145</sup> The fact that the contractor provided the services for ten years must have created an expectation to continue providing them; hence, the effect of the new policy could reasonably be perceived as a loss. Despite the fact that the contractor had no legal entitlement to win the new contract, the court issued a preliminary injunction enjoining the agency to procure the contract.<sup>146</sup>

Another pertinent example is *Ricci v. Destefano*.<sup>147</sup> In this case, the municipality of New Haven discarded the results of a test designed to determine firefighters' qualifications for promotion because, according to the test's outcomes, no black candidates were eligible for promotion. The Supreme Court, in a 5–4 decision, ruled in favor of the white and Hispanic firefighters who passed the test successfully.<sup>148</sup> The dissent correctly pointed out that the firefighters who scored high on the test “had no vested right to promotion.”<sup>149</sup> However, given the procedures and criteria for promotion, it was clear that the promotion of those who ranked highest on the test was practically guaranteed. As Justice Kennedy wrote, the “injury” experienced by those firefighters arose in part from their “high, and justified, expectations” based on participation in the testing process established by the city. “Many of the candidates had studied for months, at considerable personal and financial expense, and thus the injury caused by the City’s reliance on raw racial statistics at the end of the process was all the more

---

144. Vars, *supra* note 119, at 92 (analyzing a survey substantiating this claim).

145. 950 F. Supp. 357, 358–59 (D.D.C. 1996).

146. *Id.* at 363.

147. 129 S. Ct. 2658 (2009). Strictly speaking, the *Ricci* case did not involve an affirmative-action plan, yet this issue was explicitly discussed by both the majority and the dissent, and the relevant questions were closely connected to such plans.

148. *Id.* at 2664.

149. *Id.* at 2690 (Ginsburg, J., dissenting)

severe.”<sup>150</sup> Even ardent supporters of affirmative action can accept this line of reasoning.<sup>151</sup>

Hence, loss aversion seems to provide the soundest explanation for a basic feature of affirmative action in the United States and elsewhere: it only applies to benefits people do not yet have.<sup>152</sup>

### *E. Additional Examples*

There are numerous other illustrations of the different legal treatment of undeserved losses and undeserved gains. This Section briefly describes some.

*Social and economic rights.* In many jurisdictions, including the United States, the scope of constitutional protection afforded to social and economic rights, such as education and adequate housing, is far narrower than the constitutional protection of civil and political rights, such as the rights to life and free speech. The immense literature on this issue in constitutional and international human-rights law is often critical of the distinction and its justifications.<sup>153</sup> Indeed, none of the philosophical, institutional, historical, and cultural

---

150. *Id.* at 2681 (majority opinion). On this decision, see generally Cheryl I. Harris & Kimberly West-Faulcon, *Reading Ricci: Whitening Discrimination, Racing Test Fairness*, 58 UCLA L. REV. 73 (2010); Primus, *supra* note 142 (discussing three different readings of *Ricci* and their impact on the disparate impact doctrine).

151. A borderline case of a somewhat different type is *Wygant v. Jackson Bd. of Educ.*, 476 U.S. 267 (1986). According to an agreement between a board of education and a teachers union, if it were to become necessary to lay off teachers, those with the most seniority would be retained; yet, to preserve the effects of an affirmative hiring policy, the percentage of minority teachers laid off would not exceed their percentage in the body of employed teachers. *Id.* at 270–71. As a result, some nonminority teachers were laid off while minority teachers with less seniority were retained. *Id.* This is a borderline case because the nonminority teachers were not laid off to facilitate the hiring of new minority teachers, but rather to avoid layoffs of minority teachers already hired. Nonetheless, since the effect of the agreement on the nonminority teachers was clearly in the domain of losses—losing their jobs—it aroused strong resentment. The Supreme Court held this policy unconstitutional. *Id.* at 284.

152. Another manifestation of the role of the gains/losses distinction in the sphere of antidiscrimination laws has to do with remedies against discriminatory practices or noncompliance with affirmative-action plans. Courts are far more reluctant to deprive nonminority persons from a benefit (such as a job) that they have received in good faith, than to prohibit such an inappropriate allocation in the first place. See LINDEMANN & GROSSMAN, *supra* note 135, at 2723–26 (“Since the early days of Title VII, courts generally have refused to displace an incumbent employee in order to place the discrimination victim immediately in that position.”).

153. See, e.g., CASS R. SUNSTEIN, *THE SECOND BILL OF RIGHTS* (2004); Ruth Gavison, *On the Relationships between Civil and Political Rights, and Social and Economic Rights*, in *THE GLOBALIZATION OF HUMAN RIGHTS* 23 (Jean-Marc Coicaud et al. eds., 2003); Frank I. Michelman, *The Constitution, Social Rights, and Liberal Political Justification*, 1 INT’L J. CONST. L. 13 (2003).

explanations for the distinction are wholly persuasive. Consider, for example, the argument that civil and political rights are negative, merely requiring the state to refrain from certain acts, whereas social rights entail positive duties and substantial public expenditure. Contrary to this argument, protecting civil rights very often requires positive steps and considerable costs.<sup>154</sup> A better explanation for the lesser protection of social rights—though not necessarily a justification—rests on the gains/losses distinction. Both when the state refrains from silencing people or taking their land and when it takes positive measures to protect free speech against suppression by other people or protect private property from intruders, it prevents a loss or harm to the speaker or landowner. At the same time, freedom of speech does not necessarily require the government to provide therapy for people with speech impediments or to facilitate access to communications media. In the sphere of social rights, the provision of housing or health services is far more likely to be perceived as giving people something they do not have, and thus it would belong in the domain of gains.<sup>155</sup>

Support for this conjecture can be found in cases in which legal systems that do not generally protect social rights nevertheless impose positive duties on the government. Thus, in *Goldberg v. Kelly*, the Court held that due process forbids the *termination* of welfare benefits without a fair hearing.<sup>156</sup> In a similar vein, although the constitutional right to counsel may be perceived as providing the accused with something that she does not have, it may equally be seen as a procedural requirement when the state is about to deprive a person of liberty or property through criminal proceedings.<sup>157</sup> Finally, the notion of a reference point may also help explain why it is that, while the Constitution does not mandate the provision of economic benefits, once such benefits are provided to some segments of society, they must be provided without discrimination to similarly situated persons.<sup>158</sup> The

---

154. See generally STEPHEN HOLMES & CASS R. SUNSTEIN, *THE COST OF RIGHTS: WHY LIBERTY DEPENDS ON TAXES* (1999).

155. Cf. Susan Bandes, *The Negative Constitution: A Critique*, 88 MICH. L. REV. 2271, 2297–308 (1990) (critically discussing the penalty/subsidy distinction in the context of abortion funding cases).

156. *Goldberg v. Kelly*, 397 U.S. 254, 264 (1970).

157. Bandes, *supra* note 155, at 2277 (generalizing that “once government has acted to place a person in danger, it must protect him from that danger”); David Currie, *Positive and Negative Constitutional Rights*, 53 U. CHI. L. REV. 863, 873–74 (1986) (“[T]o characterize the right to assigned counsel as involving an affirmative government duty is to look at only a part of the transaction. In convicting an individual of crime, the government reaches out to deprive him of life, liberty, or property by execution, jail, or fine.”) (citation omitted).

158. Currie, *supra* note 157, at 881–82.

fact that certain benefits are granted to some people may change the reference point of similarly situated people such that those who do not receive them experience this as a loss.<sup>159</sup>

*Refugee law.* Under international refugee law, once asylum seekers are physically present within a country, they enjoy various substantive and procedural rights. Most important, it is forbidden to expel or return a refugee to a territory where her life or freedom would be threatened on account of such characteristics as her race, religion, or political opinions.<sup>160</sup> It is much more controversial, however, whether and to what extent countries may legitimately prevent asylum seekers from ever reaching their territory, through visa requirements, pre-entry clearance, carrier sanctions, and even interception of vessels beyond the territorial waters.<sup>161</sup> Expelling physically present people is likely perceived as inflicting a loss, while denying a visa and other pre-entry devices is seen as not providing a benefit.

*Tax law.* The notions of loss aversion and baselines can explain the popularity of tax subsidies, deductions, and credits.<sup>162</sup> Simple tax is commonly perceived as a loss to the taxpayer, and tax credits and deductions are perceived as reducing this loss. From the government's perspective, credits and deductions are perceived as unobtained revenue, rather than as direct spending. Consequently, they encounter less resistance on the part of those who do not receive them and are less stringently scrutinized.<sup>163</sup>

---

159. See *supra* note 23 and accompanying text.

160. Convention Relating to the Status of Refugees art. 33, Apr. 22, 1951; GUY S. GOODWIN-GILL & JANE MCADAM, *THE REFUGEE IN INTERNATIONAL LAW* 355–417 (3d ed. 2007); JAMES C. HATHAWAY, *THE RIGHTS OF REFUGEES UNDER INTERNATIONAL LAW* 279–370 (2005).

161. See, e.g., *Sale v. Haitian Ctrs. Council, Inc.*, 509 U.S. 155 (1993) (upholding the right to interdict Haitian refugees while they were still in international waters and return them to Haiti without an asylum hearing); HATHAWAY, *supra* note 160, at 307–42 (criticizing the *Sale* decision, yet legitimizing visa control practices); see also GOODWIN-WILL & MCADAM, *supra* note 160, at 244–57, 267–77, 369–90 (discussing states' practices and international law responses).

162. See, e.g., McCaffery, *supra* note 53, at 1941–42 (describing the role of the tax expenditure budget as a means to overcome the framing effect of tax exemptions and deductions); Edward A. Zelinsky, *Do Tax Expenditures Create Framing Effects? Volunteer Firefighters, Property Tax Exemptions, and the Paradox of Tax Expenditures Analysis*, 24 VA. TAX REV. 797 (2005) (theoretically and experimentally examining the framing effect of outright payments and tax exemptions).

163. Exposing the various pitfalls of treating tax subsidies differently from direct governmental spending, Stanley Surrey has successfully advocated the promulgation of “tax expenditure budgets.” See Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970); see also STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* (1985). For a more

*Evidence law.* The general standard of proof in civil litigation is preponderance of the evidence. Accordingly, the plaintiff prevails if she discharges the burden of persuasion—that is, if she establishes her case with a probability exceeding 0.5. When the required standard of proof is not met by either side, the risk of error is ordinarily borne by the plaintiff and her claim is dismissed.<sup>164</sup>

This allocation of risk has been justified on various grounds, including the elimination of enforcement costs,<sup>165</sup> the discouragement of unmeritorious and frivolous lawsuits,<sup>166</sup> the principle of civility,<sup>167</sup> the equality principle,<sup>168</sup> and the diminishing marginal utility of wealth.<sup>169</sup> My own justification rests on loss aversion.<sup>170</sup> There is ample experimental evidence that litigants generally view the status

---

recent discussion, see David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955 (2004); Edward D. Kleinbard, *Tax Expenditure Framework Legislation*, 63 NAT'L TAX J. 353 (2010). On the limited success of the tax expenditure budgets, see *infra* notes 245–247 and accompanying text.

164. 2 MCCORMICK ON EVIDENCE 483–86 (Kenneth S. Broun et al. eds., 6th ed. 2006) [hereinafter MCCORMICK].

165. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 647 (7th ed. 2007) (“[A]n erroneous judgment for the plaintiff imposes a cost that is avoided when the error goes the other way—the cost of collecting the judgment.”).

166. Ralph K. Winter, Jr., *The Jury and the Risk of Nonpersuasion*, 5 LAW & SOC'Y REV. 335, 337 (1971) (arguing that it is more important to deter the initiation of frivolous actions than the raising of frivolous defenses because the latter appear only after the fixed costs of a lawsuit have been incurred).

167. This principle posits that the law should and does presume that people act in accordance with serious social norms. Whenever a litigant asserts that her opponent infringed a serious norm, such as intentionally or negligently harming her or breaching a contract, the burden of proof should thus be placed on the person making these allegations. Dale A. Nance, *Civility and the Burden of Proof*, 17 HARV. J.L. & PUB. POL'Y 647 (1994).

168. This principle rests on the Kantian notion that the law must treat people in general, and plaintiffs and defendants in particular, with equal respect. Hence, the risk of error should be allocated between the parties equally. Accordingly, the plaintiff bears the burden of persuasion regarding the facts necessary to make out her case, and the defendant bears the burden regarding her affirmative defenses, such as contributory fault. ALEX STEIN, *FOUNDATIONS OF EVIDENCE LAW* 216, 219–25 (2005).

169. Assuming that plaintiffs' and defendants' levels of wealth are similar on average, the principle of diminishing marginal utility implies that the loss to the deserving plaintiff who loses her case is slightly smaller than the loss to the deserving defendant who loses. POSNER, *supra* note 165, at 647.

170. Eyal Zamir & Ilana Ritov, *Loss Aversion, Omission Bias, and the Burden of Proof in Civil Litigation*, 41 J. LEGAL STUD. (forthcoming 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1957457](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1957457) (experimentally examining the actual standard of proof in civil litigation and possible behavioral explanations for this standard); cf. Alex Stein, *Allocating the Burden of Proof in Sales Litigation: The Law, Its Rationale, a New Theory, and Its Failure*, 50 U. MIAMI L. REV. 335, 343 (1995) (indicating that imposing the burden of proof on the plaintiff “would be optimal also because *taking* is generally perceived as more harmful than not giving”). While Stein continues to argue that “[t]his perception can be justified by the diminishing utility of wealth,” he also refers to Tversky and Kahneman's theory. *Id.*

quo prior to litigation as the relevant point of reference.<sup>171</sup> The same is true of jurists.<sup>172</sup> Consequently, plaintiffs are far more likely to view judicially awarded damages and other relief as belonging in the domain of gains, and defendants are likely to view a judgment compelling them to pay damages, transfer property, or the like, as inflicting a loss. Dismissing the claim whenever there is an evidentiary tie is therefore compatible with the notion that losses (to the defendant) loom larger than unobtained gains (to the plaintiff). While not necessarily discarding other bases for the preponderance of the evidence rule, this explanation rejects the common assumption that the disutility of an erroneous judgment is typically similar for defendants and plaintiffs.<sup>173</sup>

*Miscellaneous.* In criminal law, conduct that the actor believes to be necessary “to avoid harm or evil” is justifiable under certain circumstances, but no such justification applies to conduct believed to be necessary to produce benefit or good.<sup>174</sup> Similarly, in contract law, unexpected events that render performance much more costly for the promisor, or much less beneficial for the promisee, may discharge the parties of their duty to perform on grounds of impracticability or frustration of purpose.<sup>175</sup> No such discharge is available to a promisor or a promisee who unexpectedly encounters an opportunity to make an alternative, much more lucrative bargain. The challenge of setting the baseline for determining what options constitute gains or losses is also a thorny recurrent issue whenever the law distinguishes between threats and offers, as in the context of negotiating divorce agreements

---

171. See, e.g., Rachlinski, *supra* note 51, at 128–30 (studying litigants’ decisions concerning settlements); Zamir & Ritov, *supra* note 30, at 268–69 (studying clients’ choices of attorneys’ fee arrangements).

172. See, e.g., MCCORMICK, *supra* note 164, at 474 (“The burdens of pleading and proof with regard to most facts have been and should be assigned to the plaintiff who generally seeks to change the present state of affairs . . .”).

173. See, e.g., MICHAEL FINKELSTEIN, *QUANTITATIVE METHODS IN LAW: STUDIES IN THE APPLICATION OF MATHEMATICAL PROBABILITY AND STATISTICS TO LEGAL PROBLEMS* 67 (1978) (stating that, “at least with respect to most types of civil cases” the premise that “the burden of an error is deemed to be the same for both parties” is “clearly correct”); STEIN, *supra* note 168, at 148 (arguing that “normally” in civil litigation “false positive and false negative errors are equally harmful,” yet whenever this is not the case, the decision rule should derive from the disutility differential).

174. MODEL PENAL CODE § 3.02 (1995). While describing the distinction between avoiding harm or evil and furthering societal interests as “questionable” and advocating its abandonment (thus pointing to yet another gains/losses puzzle), Paul Robinson concedes that “virtually the entire body of case law on this defense involves the avoidance of harm.” 2 PAUL H. ROBINSON, *CRIMINAL LAW DEFENSES* 46, 49 (1984).

175. RESTATEMENT (SECOND) OF CONTRACTS §§ 261–72 (1981).

and other contracts allegedly made under duress.<sup>176</sup> Finally, in civil procedure, courts are far more willing to issue preliminary injunctions that preserve the status quo than preliminary injunctions that disrupt or alter it.<sup>177</sup> This tendency is compatible with loss aversion because people are loath to depart from the status quo when doing so may result in either gains or losses.

\* \* \*

This Part analyzed several examples of fundamentally different legal treatment of seemingly similar cases in private and public law, as well as some basic rules of procedural and substantive law that seem to be puzzling in terms of both efficiency and fairness. It critically surveyed existing attempts to explain these asymmetries and puzzles. It then argued that they are all best (or at least better) explained as reflecting the psychological notions of baselines and loss aversion. The law is much more concerned with preventing, and compensating for, undeserved losses than with preventing, or disgorging, undeserved gains. In the face of uncertainty, the law ordinarily adheres to the status quo, thereby possibly depriving people of deserved gains, yet avoiding the risk of inflicting undeserved losses.

Exposing the correlation between the law and the psychological notion of loss aversion does not, in and of itself, explain or justify the pertinent legal norms. This Part briefly alluded to possible explanations and justifications, and the following Parts will explore them in a systematic and detailed fashion.

### III. EXPLAINING THE COMPATIBILITY BETWEEN LAW AND PSYCHOLOGY

This Part proposes and assesses two possible explanations for the compatibility between the fundamental characteristics of the law described above and loss aversion. According to the first theory, the aforementioned characteristics are the product of an evolutionary process propelled primarily by plaintiffs' behavior. According to the second and more powerful theory, the notions of reference points and

---

176. See, e.g., Scott Altman, *Divorcing Threats and Offers*, 15 LAW & PHIL. 209 (1996) (analyzing possible baselines for determining whether an assertion that a person would be deprived of some option, unless she agrees to something, constitutes a wrongful threat).

177. See, e.g., Thomas Lee, *Preliminary Injunctions and the Status Quo*, 58 WASH. & LEE L. REV. 109, 110 (2001) (critically discussing the rule against the backdrop of differences of opinion among federal courts in this regard); John Leubsdorf, *The Standard for Preliminary Injunctions*, 91 HARV. L. REV. 525, 526, 528, 530, 534–35, 546 (1978) (describing the history of and criticizing the rule of preserving the status quo in preliminary injunctions).

loss aversion underlie commonsense morality, which in turn informs the law.

*A. Evolutionary Theories: Plaintiffs' Role*

In most legal spheres, judges rarely base their decisions explicitly on considerations of economic efficiency (and certainly have not done so in the past). Yet, legal economists have long argued that, by and large, the common law is efficient.<sup>178</sup> One of the most intriguing explanations for this observation has been evolutionary.<sup>179</sup> Starting with the seminal articles of Paul Rubin and George Priest,<sup>180</sup> an extensive body of literature has examined the hypothesis that even if judges do not care about efficiency, a process in which inefficient rules are gradually extinguished while efficient ones survive may result from the self-serving behavior of litigants.<sup>181</sup>

All versions of this hypothesis have been sharply criticized to the extent that some are skeptical of the entire endeavor.<sup>182</sup> I nevertheless believe that this body of literature contains valuable

---

178. See, e.g., Richard A. Posner, *The Economic Approach to Law*, 53 TEX. L. REV. 757, 763–64 (1975) (arguing that legal doctrines have been strongly, though implicitly, “influenced by a concern . . . with promoting economic efficiency” and that “the logic of law is really economics”).

179. Other explanations rest on the typical convergence between the conclusions of efficiency analyses and deontological notions of corrective justice and on the claim that while judges employ the rhetoric of rights and corrective justice, they actually strive to enhance overall social welfare (at least more so than legislators). On the former argument, see generally Cass R. Sunstein, *Moral Heuristics and Moral Framing*, 88 MINN. L. REV. 1556, 1567 (2004) (“[D]eontologists and utilitarians typically agree about concrete cases . . . .”); Zamir, *supra* note 36, at 1754 (pointing to “the typical convergence of efficiency analysis and intuitive notions of justice and fairness”). For the latter argument, see RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 399–418 (2d ed. 1977).

180. Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51 (1977); George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977).

181. For a critical review of the early contributions to this literature, see E. Donald Elliott, *The Evolutionary Tradition in Jurisprudence*, 85 COLUM. L. REV. 38, 62–71 (1985). For updated surveys, see Francesco Parisi, *The Efficiency of the Common Law Hypothesis*, in 2 THE ENCYCLOPEDIA OF PUBLIC CHOICE 195–98 (Charles K. Rowley & Friedrich Schneider eds., 2004); Paul H. Rubin, *Micro and Macro Legal Efficiency: Supply and Demand*, 13 SUP. CT. ECON. REV. 19 (2005). For a collection of twenty-two major contributions to this literature, see THE EVOLUTION OF EFFICIENT COMMON LAW (Paul H. Rubin ed., 2007).

182. See, e.g., Peter H. Aranson, *The Common Law as Central Economic Planning*, 3 CONST. POL. ECON. 289, 297 (1992) (“Combinations and permutations of assumptions within [the evolutionary models of the common law] raise the possibility of millions of findings, only a few of which have been explored. The models to date thus remain profoundly inconclusive and incomplete . . . .”); Adrian Vermeule, *Common Law Constitutionalism and the Limits of Reason*, 107 COLUM. L. REV. 1482, 1521 (2007) (“After some thirty years of discussion, the fairest assessment is that the thesis of common law efficiency (at least as driven by demand-side effects) should best be taken as a possibility, no more.”).

insights that may shed light on the compatibility between loss aversion and basic features of the law. One such insight is that the direction of the law's evolution is not only set by courts' reasoned decisions; the behavior of the litigants is important as well.<sup>183</sup> Another insight is that, even prior to the decision of whether to litigate or settle a case, the existence of a dispute is a precondition for the evolution of judge-made law, efficient or not.<sup>184</sup> No judge-made rule could evolve absent a legal dispute.

Since the basic features of the law I aim to explain via the notions of reference points and loss aversion are rather general and mostly characteristic of both modern and premodern systems, it seems appropriate to initially focus on the formative periods of the law, when litigants primarily cared about the resolution of specific disputes. The growing impact of small, well-organized interest groups who are repeat players in a certain sphere of activity and can strategically orchestrate adjudication so as to produce favorable precedents is a relatively recent phenomenon.<sup>185</sup> At any rate, I shall argue that the presence of organized interest groups need not alter the conclusion.

The economic literature assumes that whenever there is a legal dispute, the parties decide whether to litigate or settle out of court according to the expected costs and benefits of each alternative.<sup>186</sup> This assumption does not distinguish between cases in which a potential plaintiff seeks redress for a loss allegedly inflicted on her and cases in which she seeks to attain a benefit she never had. There

---

183. According to Priest's original argument, inefficient rules generate more litigation. The more a rule is litigated, the greater the chances that it will be changed. Efficient rules survive simply because they generate less litigation—and thus offer fewer opportunities to alter them. Priest, *supra* note 180. In the same spirit, when a rule inefficiently allocates an entitlement to someone who values it less than someone else, the latter is likely to exert more effort to challenge the rule than the former is to defend it. Since litigants who expend more effort are more likely to prevail, courts are more prone to overturning inefficient rules. John C. Goodman, *An Economic Theory of the Evolution of the Common Law*, 7 J. LEGAL STUD. 393 (1978).

184. See, e.g., Jeffrey Evans Stake, *Status and Incentive Aspects of Judicial Decisions*, 79 GEO. L.J. 1447, 1492 (1991) (“[I]f the law places the incentive to avoid the situation leading to the dispute on the party that can more cheaply avoid the situation, the situation will arise less often. . . . [T]he incentive-efficient rule would be in effect longer than the inefficient rule because disputes would not arise as quickly.”). For a parallel hypothesis regarding the evolution of protomorality and morality through third-party interference in conflicts among members of cooperating groups of primates (yielding generalized moral, and eventually legal, norms), see Christopher Boehm, *The Evolutionary Development of Morality as an Effect of Dominance Behavior and Conflict Interference*, 5 J. SOC. & BIOL. STRUCTURES 413 (1982).

185. Paul H. Rubin, *Common Law and Statute Law*, 11 J. LEGAL STUD. 205 (1982) (arguing that the efficiency of the common law is primarily due to the fact that most common law rules were developed through the early twentieth century when the costs of organizing interest groups were high).

186. See, e.g., Rubin, *supra* note 180 (discussing the parties' decisions to settle or litigate under different circumstances).

is presumably no difference between causes of action resting on civil wrongs and those resting on unjust enrichment. Similarly, the economic analysis does not distinguish between a case in which, following a breach of contract, the nonbreaching party claims reliance or expectation damages and a case in which she claims a disgorgement relief. In these and comparable cases, the law may either recognize or deny the plaintiff's legal entitlement, and, in all cases, current rules may be either efficient or inefficient.

If, however, people perceive losses as much more painful than unobtained gains, then potential plaintiffs would be much less inclined to sue for unobtained gains than for losses. In the case of unobtained gains, oftentimes people do not experience any disutility or experience at most a negligible one. In such cases, no dispute would arise. And even if some disutility is experienced for unobtained gains, it is less likely to be large enough to induce people to sue for legal relief or even threaten to do so. Filing a suit or threatening to file one entails considerable costs: monetary, reputational, emotional, and so forth.<sup>187</sup> Since unobtained gains are less likely to produce disutility large enough to justify legal action (or, in ancient societies, recourse to informal dispute-resolution mechanisms), considerably fewer disputes are expected to revolve around unobtained gains. As legal norms develop out of disputes, it stands to reason that the law of unjust enrichment, governmental givings, and disgorgement remedies would be considerably less developed than the law of torts, governmental takings, and reliance or expectation remedies.<sup>188</sup> This would be the case whether the resulting dissimilarities between the norms governing each part of these pairs are efficient or inefficient, fair or unfair.<sup>189</sup>

---

187. See, e.g., Stuart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 60–67 (1963) (documenting the strong inclination of businesspeople to resolve disputes through nonlegal mechanisms and their reasons for avoiding the legal system); Jon O. Newman, *Rethinking Fairness: Perspectives on the Litigation Process*, 94 YALE L.J. 1643 (1985) (discussing the costs of litigation).

188. Cf. William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 259–84 (1979). Whereas the basic economic, evolutionary argument assumed that the more a rule is litigated, the more it is likely to be changed, Landes and Posner cogently point out that repeat litigation may actually strengthen existing precedents. *Id.*

189. Note that this hypothesis uses the notions of reference points and loss aversion to explain how people's perceptions shape the law. In contrast, recent contributions to the efficiency-of-the-common-law literature use comparable notions to explain the complementary process by which the law shapes people's perceptions. See Adam J. Hirsch, *Evolutionary Theories of Common Law Efficiency: Reasons for (Cognitive) Skepticism*, 32 FLA. ST. U. L. REV. 425, 429–30, 434 (2005) (arguing that due to the status quo bias, the law's effect on people's valuations of entitlements may hinder the evolution of efficient rules); Robert L. Scharff & Francesco Parisi, *The Role of Status Quo Bias and Bayesian Learning in the Creation of New Legal Rights*, 3 J.L.

While this hypothesis focuses on judge-made law evolving as a result of the behavior of plaintiffs who are single-shot players, it basically holds true when we turn our attention to the “supply side” of precedents, consider plaintiffs who are repeat players, and reflect on statutory law. As for supply-side evolution, the efficiency-of-the-common-law hypothesis posits that competition between courts has been conducive to the emergence of efficient common law because litigants preferred courts implementing efficient norms.<sup>190</sup> To the extent that one accepts this argument,<sup>191</sup> once we add loss aversion to the analysis, competition between courts is expected to yield asymmetries of the sort that we discuss. A court devoting resources to the development of legal entitlements that are not in much demand is likely to fare worse than a court developing and implementing norms that better match litigants’ (and in particular, plaintiffs’) concerns. If loss-averse plaintiffs care much more about losses than unobtained gains, responsive courts would produce a set of rules reflecting this common perception.

Regarding litigants who are repeat players, several scholars have argued that small, well-organized interest groups are likely to fare better in courts than single-shot litigants, thus obstructing the evolution of an efficient common law.<sup>192</sup> Inasmuch as repeat players are rational maximizers, their presence may similarly weaken the present hypothesis. However, while the experimental and empirical data is not unequivocal, there is much support for the proposition that loss aversion characterizes choices made by experienced decisionmakers, including businesspeople.<sup>193</sup> In fact, some studies

---

ECON. & POLY 25 (2006) (arguing that status quo bias may transform ex ante inefficient rules into ex post efficient ones). I discuss these issues in Part IV.C.

190. Todd J. Zywicki, *The Rise and Fall of Efficiency in the Common Law: A Supply-Side Analysis*, 97 NW. U. L. REV. 1551 (2003).

191. The weakness of the argument lies in the fact that competition between courts need not necessarily lead to more efficient rules. Such competition allows plaintiffs to select courts that tend to impose broader liability and award more generous relief whether the ensuing norms are efficient or not. Vincy Fon & Francesco Parisi, *Litigation and the Evolution of Legal Remedies: A Dynamic Model*, 116 PUB. CHOICE 419 (2003) (discussing plaintiff’s control and incentives in bringing a case to court).

192. See, e.g., Rubin, *supra* note 180, at 55–56; see also Aranson, *supra* note 182, at 297.

193. See, e.g., Joshua D. Coval & Tyler Shumway, *Do Behavioral Biases Affect Prices?*, 60 J. FIN. 1, 1 (2005) (finding that Chicago Board of Trade proprietary traders display high loss aversion, regularly assuming above-average afternoon risk to recover from morning losses); J.B. McNeil et al., *On the Elicitation of Preferences for Alternative Therapies*, 306 NEW ENGLAND J. MED. 1259 (1982) (describing an experiment in which physicians’ choices between alternative medical treatments depended on the manner in which the data was presented to them: probability of death or probability of survival); Robert A. Olsen, *Prospect Theory as an Explanation of Risky Choice by Professional Investors: Some Evidence*, 6 REV. FIN. ECON. 225 (1997) (finding that the perceptions and preferences of professional investment managers

indicate that professionals display greater loss aversion than laypeople.<sup>194</sup> It follows that the activity of repeat players may indeed affect judge-made law, yet it is unlikely to counteract the tendency to provide considerably greater legal protection for losses than for unobtained gains. Like anybody else, repeat players, too, are likely to resent losses more than unobtained gains. Nevertheless, one should concede that the greater the proportion of litigants who are not loss averse, the less powerful the present theory is.

Similar arguments can be made regarding the supply and demand (including demand by interest groups) of statutory and even constitutional law. While legal economists are often suspicious of legislators' motives and hence about the efficiency of statutory law, they have long observed that the evolutionary model of the common law is in principle applicable to the legislative process as well.<sup>195</sup> At the same time, the distortions resulting from effective rent seeking by well-organized interest groups are even more relevant to the legislative arena.<sup>196</sup> However, as long as interest groups invest more energy in the fight against initiatives that would deprive them of entitlements they already have than in the campaign for new

---

comport with PT); Zur Shapira & Itzhak Venezia, *Patterns of Behavior of Professionally Managed and Independent Investors*, 25 J. BANKING & FIN. 1573, 1577 (2001) (similar findings). For opposite findings, see, for example, John A. List, *Neoclassical Theory vs. Prospect Theory: Evidence from the Marketplace*, 72 ECONOMETRICA 615 (2004) (finding that people with intense market experience behave largely in accordance with neoclassical economy predictions).

194. See, e.g., Sheharyar Bokhari & David Geltner, *Loss Aversion and Anchoring in Commercial Real Estate Pricing: Empirical Evidence and Price Index Implications*, 39 REAL ESTATE ECON. 635 (2011) (sophisticated, commercial investors); Michael S. Haigh & John A. List, *Do Professional Traders Exhibit Myopic Loss Aversion? An Experimental Analysis*, 60 J. FIN. 523 (2005) (professional traders).

195. See, e.g., GORDON TULLOCK, TRIALS ON TRIAL: THE PURE THEORY OF LEGAL PROCEDURE 198 (1980) (“[I]nsofar as this model does indicate that judicial proceedings would tend toward efficiency, it indicates that both legislative and executive rule making would have a much stronger tendency.”); Jack Hirshleifer, *Evolutionary Models in Economics and Law: Cooperation Versus Conflict Strategies*, 4 RES. L. & ECON. 1, 47 (1982) (“[T]he thrust of this efficiency-through-strength argument is by no means limited to the arena of common law litigation. With minimal modifications the same logic can be applied also to the forces determining statute law . . . .”); Rubin, *supra* note 180, at 61 (applying the evolution-of-the-common-law analysis to statutory law); Vermeule, *supra* note 182, at 1524–26 (“Over time, inefficient precedents will be challenged more often and more frequently overturned. This model is, however, essentially the same as a standard model suggesting that legislation will be efficient, and for the same reasons.”).

196. TULLOCK, *supra* note 195, at 186–206 (comparing lawmaking by courts with other sources of law); Rubin, *supra* note 180, at 61 (comparing the behavior of well-defined small groups in the legislative arena to that of repeat players in litigation); Rubin, *supra* note 185 (arguing that the greater efficiency of the common law is primarily due to the fact that most common law rules were developed when the costs of organizing interest groups were high); see also Becker, *supra* note 87 (formulating a general theory of rent-seeking by pressure groups in the political arena).

entitlements (which is plausibly the case), the proposed theory holds true.

The present theory is more modest than the efficiency-of-the-common-law hypothesis, and hence expectantly less objectionable. The efficiency-of-the-common-law hypothesis, like economic analysis of law in general, is potentially relevant to every legal norm. Therefore, it might be criticized on the grounds that it does not provide concrete, testable predictions regarding specific rules and that in fact the common law is sometimes inefficient. In contrast, I do not argue that loss aversion explains the intricacies of any legal field. Rather, I offer it as an explanation for general, basic features of the law.

The present suggestion is also more modest in the sense that it is not offered as an exclusive or even the primary explanation for the compatibility between loss aversion and the law. At the end of the day, it is only meant as supplementary to the explanation that will be discussed below. This caution is appropriate for several reasons. First, the evolutionary theory explains why losers are more likely to file suits than no-gainers. However, even if a loss is two, three, or four times more painful than an unobtained gain, one should only expect significant difference in the rate of lawsuits with regard to relatively small gains. For instance, if losers typically file suits only for losses exceeding \$10,000, and if losses are three times more painful than unobtained gains, then one would expect plaintiffs to file suits for unobtained gains exceeding \$30,000. Still, there should be many such cases. Hence, while an evolutionary theory based on loss aversion may explain why legal norms dealing with losses develop faster than norms dealing with unobtained gains, it does not necessarily account for the dramatic differences observed in Part II between governmental takings and givings, tort and unjust enrichment, firing and not hiring, and so forth. At the same time, if one takes the analogy between legal and biological evolution seriously, and if the resources of litigants, lobbyists, and legal policymakers are limited, then one would expect that the greater resources devoted to developing doctrines protecting people from losses would crowd out doctrines dealing with unobtained gains. Another response is that, while norms dealing with losses are more developed than those dealing with unattained gains, the latter do exist.

Another reason for cautiousness pertains to the examples of tort versus unjust enrichment and the expectation versus disgorgement remedies for breach of contract. In these cases, the same incident can involve both losses to one person and gains to another. In such cases, while the losses to the plaintiff may induce her to file a suit, once she takes legal action there is no apparent reason for her to

content herself with claiming her losses if the defendant's gains are larger than these losses.<sup>197</sup> In response, I note that these cases represent only a small fraction of the cases discussed in Part II. Moreover, it stands to reason that at least some plaintiffs fail to base their claims on defendants' gains because they do not view these gains as something to which they are entitled.

Finally, the evolutionary theory may be criticized on the grounds that, from the plaintiff's perspective, legal relief may always be perceived as belonging in the domain of gains.<sup>198</sup> This difficulty does not apply to the commonsense morality explanation discussed below, as the latter focuses on the standpoint of the impartial policymaker, who is more likely to view the entire course of events and do so from an *ex ante* perspective. Like the previous critiques of the evolutionary hypothesis, however, this critique is not fatal, as it remains true that people who incurred a loss are more strongly motivated to seek legal redress than people who failed to obtain a gain. Yet, it does somewhat weaken the evolutionary theory. The next Section thus turns to what seems to be a more powerful explanation, focusing on the mindset of legal policymakers.

### *B. Cognitive Psychology, Commonsense Morality, and the Law*

While the evolutionary hypothesis discussed above is plausible, a more robust explanation for the compatibility between the psychological notion of loss aversion and the law seems to rest on an intermediate factor: commonsense morality. This explanation posits that, by and large, the law conforms to prevailing moral intuitions, and since the latter are closely linked to notions of reference points and loss aversion, these notions shape the law as well.

Commonsense morality is deontological. People believe that enhancing good outcomes is desirable, yet they also hold that attaining this goal is subject to moral constraints. These constraints include prohibitions against lying, against breaking promises, and most importantly, against intentionally or actively harming other people. Because such acts are inherently wrong, they are impermissible even as a means to furthering overall good. It is immoral to kill one person and harvest her organs to save the lives of three other people. It is similarly immoral to torture the baby daughter of a terrorist to force him to reveal information that would

---

197. See also *supra* notes 56, 71, 132 and accompanying text.

198. See *supra* note 171 and accompanying text.

save some lives.<sup>199</sup> At the same time, commonsense morality recognizes options: under many circumstances, an agent may legitimately prefer her own interests and the interests of her beloveds or members of her community over the enhancement of the overall good.<sup>200</sup> Commonsense morality largely comports with moderate, rather than absolutist, deontology. It accepts that constraints and options have thresholds. When enough good (or, much more commonly, bad) is at stake, one may justifiably infringe a constraint (or have no option not to maximize the good).<sup>201</sup>

Deontology does not primarily judge the morality of an action (or anything else) according to its outcomes but rather focuses on the morality of the action itself.<sup>202</sup> The fact that a person is tortured is a bad thing; and if two people are tortured, it is certainly worse. However, for the deontologist, the fact that she tortures one person may well be worse than the fact that, somewhere in the world, two people are being tortured by someone else. Being deontological, commonsense morality is distinctively agent-relative (rather than agent-neutral).<sup>203</sup>

Deontological morality distinguishes between harming a person and not benefiting her. While this distinction—often phrased in terms of avoiding pain versus promoting happiness—may be endorsed by consequentialists,<sup>204</sup> it is primarily embedded in deontological and commonsense morality. Were promotion of the good as compelling as eliminating the bad, the doing/allowing distinction, which is essential for the deontological moral constraint against

199. On the basic tenets of deontological morality see generally SHELLY KAGAN, *NORMATIVE ETHICS* 70–78 (1998); ZAMIR & MEDINA, *supra* note 106, at 41–42.

200. See generally KAGAN, *supra* note 199, at 161–70.

201. *Id.* at 78–84 (discussing thresholds); ZAMIR & MEDINA, *supra* note 106, at 46–47. On the compatibility between commonsense morality and moderate deontology, see, for example, Samantha Brennan, *Thresholds for Rights*, 33 S.J. PHIL. 143, 145 (1995) (“The view that (many if not all) rights have thresholds is . . . an extremely common one, both among the general public and among philosophers engaged in moral theory.”); Samuel Scheffler, *Introduction, in CONSEQUENTIALISM AND ITS CRITICS* 1, 9 (Samuel Scheffler ed., 1988) (“Indeed, most would agree that [deontological constraints and options] mirror everyday moral thought much more closely than consequentialism does.”). Even critics of threshold deontology readily admit that it comports with commonsense morality much better than rival theories. SHELLY KAGAN, *THE LIMITS OF MORALITY* 1–5 (1989).

202. Stephen Darwall, *Introduction, in DEONTOLOGY* 1 (Stephen Darwall ed., 2003).

203. ZAMIR & MEDINA, *supra* note 106, at 41–42; see also STEPHEN DARWALL, *THE SECOND-PERSON STANDPOINT: MORALITY, RESPECT, AND ACCOUNTABILITY* 37 (2006) (noting that agent relativity is part of moral common sense).

204. James Griffin, *Is Unhappiness Morally More Important than Happiness?*, 29 PHIL. Q. 47, 47 (1979). In fact, this judgment is often labeled “negative utilitarianism.” See, e.g., R.N. Smart, *Negative Utilitarianism*, 67 MIND 542 (1958); A.D.M. Walker, *Negative Utilitarianism*, 83 MIND 424 (1974).

harming people, would have collapsed. According to this distinction, whereas it is forbidden to actively inflict pain or loss on people, there is no constraint—or more precisely, a considerably less stringent constraint—against allowing people to suffer an injury or a loss.<sup>205</sup> The prohibition against killing one person in order to harvest her organs to save the lives of three other people necessarily implies that actively killing an involuntary “donor” is worse than allowing the death of three other people. Otherwise, there would be a prohibition against both killing the one and not killing her (thereby allowing the death of the three). Now, whenever an agent abides by the prohibition against actively doing harm (e.g., refrains from killing one person), she simultaneously avoids *doing harm* to the one and avoids *doing good* to the three. The doing/allowing distinction, which is essential to deontological constraints and commonsense morality, thus inevitably entails a doing good/doing bad distinction. Promoting the good is less morally compelling than eliminating the bad.<sup>206</sup>

The same argument holds true if instead of the doing/allowing distinction, one adopts the intending/foreseeing distinction. Take, for example, the famous “trolley problem.” An uncontrolled trolley is hurtling down a track. Directly in its path stand five people who cannot escape and will be killed by the runaway trolley. An agent can flip a switch, diverting the trolley to another track where it will kill a single individual. Should the agent flip the switch? Alternatively, suppose that the only way that the agent can save the five people is by causing another individual to fall onto the track, thereby blocking the trolley while killing that individual. Should the agent cause the other individual’s fall? Most people find diverting the trolley morally permitted, perhaps even required, but they find using another person to block the trolley morally forbidden. Deontologists ground the difference in the distinction between killing as a mere *side effect* in the diverting scenario—that is, *foreseeing* harm—and killing as a *means*

---

205. See KILLING AND LETTING DIE (Bonnie Steinbock & Alastair Norcross eds., 2d ed. 1994) (a collection of studies of the doing/allowing distinction); KAGAN, *supra* note 199, at 94–100 (a critical overview of “doing” versus “allowing”); KAGAN, *supra* note 201, at 83–127 (a critique). For psychological studies substantiating the prevalence of this intuition, see, for example, Ilana Ritov & Jonathan Baron, *Reluctance to Vaccinate: Omission Bias and Ambiguity*, 3 J. BEHAV. DECISION MAKING 263 (1990) [hereinafter Ritov & Baron, *Reluctance*]; Jonathan Baron & Ilana Ritov, *Reference Points and Omission Bias*, 59 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 475 (1994) [hereinafter Baron & Ritov, *Reference Points*].

206. On this distinction, see KAGAN, *supra* note 201, at 121–25 (a critique); F.M. Kamm, *Non-Consequentialism, the Person as an End-in-Itself, and the Significance of Status*, 21 PHIL. & PUB. AFF. 354, 381–82 (1992) (a reply to the critique); see also N. Ann Davis, *The Priority of Avoiding Harm*, in KILLING AND LETTING DIE, *supra* note 205, at 298 (criticizing the deontological distinctions).

in the blocking scenario—that is, *intending* harm.<sup>207</sup> Now, if it is forbidden to use a person to block the trolley, this necessarily implies that intending good (saving the five) is less compelling than not intending bad (killing the one as a means). The intending/foreseeing distinction hence entails a distinction between *intending good* and *intending bad*.<sup>208</sup>

The distinction between promoting the good and eliminating the bad is also part of the prevailing moral belief about options. While people are expected to make occasional sacrifices in order to eliminate the bad, such as providing bare necessities to the underprivileged, they are not required to make sacrifices to promote the good, such as further enhancing the welfare of the privileged, even if doing so would increase aggregate welfare.

The judgment that preventing the bad is more compelling than promoting the good is subject to serious philosophical objections.<sup>209</sup> It nevertheless reflects widely held moral intuitions.<sup>210</sup>

The moral distinction between promoting the good and eliminating the bad straightforwardly corresponds with the psychological notions of reference points and loss aversion. Losses, unhappiness, disutility, and harm loom larger than gains, happiness, utility, and benefit. Parenthetically, one may also observe a correspondence between the deontological doing/allowing distinction (which is closely connected to the doing good/doing bad distinction) and the psychological omission bias (closely connected to status quo bias and loss aversion).<sup>211</sup> Indeed, most of the psychological studies

207. On the trolley problem, see generally PHILIPPA FOOT, *The Problem of Abortion and the Doctrine of the Double Effect*, in VIRTUES AND VICES AND OTHER ESSAYS IN MORAL PHILOSOPHY 19, 23 (1978); F.M. Kamm, *Harming Some to Save Others*, 57 PHIL. STUD. 227 (1989); Alison McIntyre, *Doing Away with Double Effect*, 111 ETHICS 219 (2001); Judith Jarvis Thomson, *The Trolley Problem*, 94 YALE L.J. 1395 (1985).

208. For the claim that deontology must resort to the doing/allowing, intending/foreseeing, or some such distinction (which in turn, as demonstrated, entails a distinction between doing/intending good and doing/intending bad), see David Enoch, *Intending, Foreseeing, and the State*, 13 LEGAL THEORY 69, 97–99 (2007).

209. See, e.g., Griffin, *supra* note 204 (critically discussing different versions of affording greater moral weight to unhappiness than to happiness and concluding that none of them is plausible); R.I. Sikora, *Negative Utilitarianism: Not Dead Yet*, 85 MIND 587 (1976) (criticizing the modest version of negative utilitarianism proposed by Walker, *supra* note 204); Smart, *supra* note 204 (arguing that negative utilitarianism allows for absurd and even wicked moral judgments).

210. For psychological evidence of this intuition, see, for example, Jonathan Baron & Mark Spranca, *Protected Values*, 70 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 1, 10–11 (1997) (finding that people are much more supportive of medical intervention aimed at increasing newborns' IQs from subnormal to normal than from normal to superior).

211. On the linkage between omission bias and loss aversion, see Maya Bar-Hillel & Efrat Neter, *Why Are People Reluctant to Exchange Lottery Tickets?*, 70 J. PERSONALITY & SOC.

focus on people's perceptions and choices regarding gains and losses to themselves, whereas morality centers on the effects of one's conduct on other people. However, it has been established that loss aversion characterizes not only people's perceptions and choices regarding their own health, wealth, or welfare, but also regarding the effects of one's decisions and behavior on the health, wealth, or welfare of others.<sup>212</sup> Therefore, even if one sets aside the evolutionary explanations based on plaintiffs' behavior discussed in Part III.A, the prevailing moral intuitions of legal policymakers—legislators, judges, and administrators—may explain the manifest correlation between psychology and law described in Part II.

In addition to the close correspondence between psychology and morality, this thesis assumes a correlation between morality and law. It should be noted that such a correlation does not assume any particular philosophical theory of law. It is of course compatible with natural law theories holding that law is intimately connected with morality and that an immoral law is not valid.<sup>213</sup> Yet, it is also compatible with legal positivism. While rejecting the notion that the validity of law depends on its merits,<sup>214</sup> legal positivists do not deny the connection between law and morality. For instance, H.L.A. Hart readily concedes that “[t]he law of every modern state shows at a

---

PSYCHOL 17, 25 (1996) (concluding that people's reluctance to exchange lottery tickets rests on loss aversion: “[T]he state of the world in which one's original ticket wins (or . . . could have won) but the new one does not, represents a 'loss,' whereas the state of the world in which the new ticket, had one exchanged for it, would have won, but holding onto one's original ticket results in no win, is merely a foregone gain.”); *supra* note 34 and accompanying text.

212. *See, e.g.*, Baron & Ritov, *Reference Points*, *supra* note 205, at 483–89 (describing an experiment in which respondents were asked to imagine themselves as government officials facing a decision whether to change a policy that is expected to affect the unemployment rate); Moshinsky & Bar-Hillel, *supra* note 20 (studying policy choices); Ritov & Baron, *Reluctance*, *supra* note 205 (describing experiments in which participants were asked whether they would support a law mandating the vaccination of all children where the vaccination would eliminate the risk of death from flu but may have fatal side effects); Vars, *supra* note 119 (studying people's attitudes to affirmative-action plans that involve either not giving or taking from others). While the studies of Baron and Ritov focused on the omission bias, as the second study has established, this bias is closely connected to loss aversion. Thus, a vaccination entails both *active* provision of a gain (eliminating the risk of death from the flu) and *active* infliction of a loss (exposing to the risk of death from the vaccine). A choice not to vaccinate when the magnitude of the latter risk is about half the size of the former implies that losses loom larger than gains. *See also supra* note 211 and accompanying text.

213. *See, e.g.*, David O. Brink, *Legal Positivism and Natural Law Reconsidered*, 68 *MONIST* 364, 365 (1985) (“[Natural law theory of legal validity] claims that morality is a necessary and perhaps also a sufficient condition of legality.”).

214. *Id.* at 365 (“[Legal positivism theory of legal validity] denies that morality is either a necessary or a sufficient condition of legality.”); John Gardner, *Legal Positivism: 5½ Myths*, 46 *AM. J. JURIS.* 199, 199 (2001) (defining the core of legal positivism as the claim that “[i]n any legal system, whether a given norm is legally valid, and hence whether it forms part of the law of that system, depends on its sources, not its merits”).

thousand points the influence of both the accepted social morality and wider moral ideals. These influences enter into law either abruptly and avowedly through legislation, or silently and piecemeal through the judicial process.”<sup>215</sup> Hart further states that “[n]o ‘positivist’ could deny . . . that the stability of legal systems depends in part upon [certain] types of correspondence with morals.”<sup>216</sup>

Indeed, one can hardly deny that legal norms very often are commensurate with moderate deontology and commonsense morality. One example is the compatibility between the doing/allowing and intending/foreseeing distinctions and various aspects of criminal liability.<sup>217</sup> In contract law, the limits on precontractual disclosure duties (even when broader duties would likely promote the overall good) are best understood as embodying deontological options.<sup>218</sup> Likewise, the radically different legal treatment of liquidated damages for delay versus bonuses for earlier completion (where the agreed-upon completion date serves as a reference point) clearly rests on the deontological duty to keep one’s promise.<sup>219</sup> Finally, the discussion in Part II referred to several basic features of the law that correspond to the distinction between doing bad (inflicting a loss) and doing good (conferring a gain), which the deontological doing/allowing and intending/foreseeing distinctions presuppose.

The proposed correspondence between psychology, morality, and law falls into line with recent theories of evolutionary psychology, evolutionary morality, and moral psychology. At the risk of oversimplification, these intriguing theories posit that human morality is largely innate—the outcome of a long process of evolutionary adaptation.<sup>220</sup> Just as the human brain is genetically

215. H.L.A. HART, *THE CONCEPT OF LAW* 203–04 (2d ed. 1994).

216. *Id.* at 204; *see also* Gardner, *supra* note 214, at 222–23 (describing the legal positivism thesis that “there is no necessary connection between law and morality” as “absurd” and as one that “no legal philosopher of note has ever endorsed”); Neil MacCormick, *Natural Law and the Separation of Law and Morals*, in *NATURAL LAW THEORY: CONTEMPORARY ESSAYS* 105, 107 (Robert P. George ed., 1992) (rejecting the notion that “positivists are amoralists, or unconcerned about the moral quality of the positive law”).

217. *See* Michael S. Moore, *Torture and the Balance of Evils*, 23 *ISR. L. REV.* 280, 299–314 (1989) (describing seven deontological distinctions and their correspondence with three aspects of legal culpability).

218. ZAMIR & MEDINA, *supra* note 106, at 289–91.

219. *Id.* at 301–03.

220. There is an abundant literature on evolutionary and moral psychology. For general overviews and useful collections of essays, *see* RICHARD JOYCE, *THE EVOLUTION OF MORALITY* (2006); *ISSUES IN EVOLUTIONARY ETHICS* (Paul Thompson ed., 1995); *1 MORAL PSYCHOLOGY: THE EVOLUTION OF MORALITY: ADAPTATIONS AND INNATENESS* (Walter Sinnott-Armstrong ed., 2008) [hereinafter *MORAL PSYCHOL.*]; William FitzPatrick, *Morality and Evolutionary Biology*, in *THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY* (2008), *available at* <http://plato.stanford.edu/>

equipped with a specific ability to acquire language (the Chomskyan theory of “universal grammar”),<sup>221</sup> it is genetically equipped with a kind of “moral grammar.” This innate moral grammar structures people’s moral judgments, thereby indirectly informing the law. Proponents of these theories neither dispute the considerable divergence of moral norms in different societies nor deny the significant role that social environment plays in inculcating particular moral norms. Even if all people share the same innate psychological mechanisms, these mechanisms may generate diverse moral norms under different environments (just as languages vastly differ from one another).<sup>222</sup> Yet, they argue that some basic structural features of morality are universal. Among these very basic, universal characteristics, one finds deontological agent-relativity.<sup>223</sup> Arguably, the fact that commonsense morality is deontological is no coincidence; it is an innate and universal characteristic of the human species.

In addition to the relevance of these theories to biology, psychology, anthropology, and moral philosophy, they may contribute to legal theory.<sup>224</sup> Some scholars argue that evolutionary analyses may not only improve our understanding of legal norms but even inform

---

archives/win2008/entries/morality-biology; John Tooby & Leda Cosmides, *The Psychological Foundations of Culture*, in *THE ADAPTED MIND: EVOLUTIONARY PSYCHOLOGY AND THE GENERATION OF CULTURE* 19 (Jerome H. Barkow et al. eds., 1992).

221. For an overview and references, see, for example, VIVIAN COOK & MARK NEWSON, *CHOMSKY’S UNIVERSAL GRAMMAR: AN INTRODUCTION* (2d ed. 1996); S. Cristofaro, *Linguistic Universals, Chomskyan*, in 7 *ENCYCLOPEDIA OF LANGUAGE AND LINGUISTICS* 222–24 (2d ed. 2006).

222. JOYCE, *supra* note 220, at 5 (explaining that evolutionary psychology does not “imply that an adaptation must result in cross-cultural universals in human behavior,” as “[t]he evolved mechanisms may be designed to be environmentally sensitive, may operate unexpectedly in unanticipated environments, or may not develop at all if not properly triggered”); Robin Bradley Kar, *The Deep Structure of Law and Morality*, 84 *TEX. L. REV.* 877, 893 (2006) (maintaining that the deep structure of moral psychology is “perfectly consistent with the broadest range of moral and legal views”).

223. MARC D. HAUSER, *MORAL MINDS: HOW NATURE DESIGNED OUR UNIVERSAL SENSE OF RIGHT AND WRONG* 111–31 (2006) (describing large-scale experiments attesting to remarkable uniformity in people’s reactions to various versions of the trolley problem and comparable moral dilemmas, along with people’s difficulty to explain their intuitive judgments); JOHN MIKHAIL, *ELEMENTS OF MORAL COGNITION* (2011) (proposing a general theory of innate, universal moral grammar); Kar, *supra* note 222, at 902, 924–31.

224. See generally Kar, *supra* note 222 (arguing that law and morality share a deep and pervasive structure, arising from the fact that both engage psychological adaptations that facilitate the solving of various social contract problems). For the stronger and more problematic claim that, just as there is an innate linguistic and moral grammar, there is also a universal legal grammar or a “law instinct,” see Michael D. Guttentag, *Is There a Law Instinct?*, 87 *WASH. U. L. REV.* 269 (2009). For the radical and questionable claim that “a universal system of basic rights is hardwired into our brains” and that this system includes property rights, a right to basic fairness, liberty rights, and a right to be treated equally, see Edwin Fruehwald, *A Biological Basis of Rights*, 19 *S. CAL. INTERDISC. L.J.* 195, 212–28 (2010).

legal policymaking. Since law strives to affect human behavior, it must understand what causes this behavior, including its biological and evolutionary sources. For instance, it has been suggested that evolutionary analysis provides insight into such phenomena as infanticide by stepfathers, and more broadly, sheds light on the role of emotions and various heuristics in human decisionmaking.<sup>225</sup> Complementarily, it is argued that the core concepts of universal legal fields as criminal law, torts, and contracts can inform moral psychology.<sup>226</sup>

The tenets of evolutionary psychology in general and its relevance to legal policymaking in particular have been subject to powerful critique. No one denies that people are born with a capacity to learn and internalize moral norms. However, some contend that this capacity is part of our general-purpose learning system, or at least that nothing in the current scientific evidence compellingly proves otherwise.<sup>227</sup> Thus, universal moral grammar is as controversial as Chomsky's linguistic theory.<sup>228</sup> With regard to legal regulation, it is conceded that, in principle, understanding the biological etiology of human behavior can contribute to legal regulation. First, such etiology is important if there is a correlation between the innateness of a certain trait and its being unsusceptible

225. Jones & Goldsmith, *supra* note 42, at 432–54; *see also* Owen D. Jones, *Time-Shifted Rationality and the Law of Law's Leverage: Behavioral Economics Meets Behavioral Biology*, 95 NW. U. L. REV. 1141, 1190–96 (2001) (arguing that the more adaptive the predisposition contributing to a certain behavior has been in the evolutionary process, the more difficult it would be to alter it through legal incentives).

226. John Mikhail, *Moral Grammar and Intuitive Jurisprudence: A Formal Model of Unconscious Moral and Legal Knowledge*, 50 PSYCHOL. LEARNING & MOTIVATION 27, 30 (2009) (arguing that “untutored adults and even young children are intuitive lawyers, who are capable of drawing intelligent distinctions between superficially similar cases,” hence “future research in moral psychology should” move beyond “pedagogically useful examples such as the trolley problem and other cases of necessity to the core concepts of universal fields like tort, contracts, criminal law, property, agency, equity, procedure and unjust enrichment . . .”); *see also* John Mikhail, *Is the Prohibition of Homicide Universal?: Evidence from Comparative Criminal Law*, 75 BROOK. L. REV. 497 (2009) (exposing uniform features of the crime of homicide).

227. Jesse J. Prinz, *Is Morality Innate?*, in MORAL PSYCHOL., *supra* note 220, at 367; *see also* Elisabeth A. Lloyd & Marcus W. Feldman, *Evolutionary Psychology: A View From Evolutionary Biology*, 13 PSYCHOL. INQUIRY 150 (2002) (arguing that the reduced version of evolutionary biology incorporated into much of evolutionary psychology leads to faulty science). *But see* Bruce J. Ellis & Timothy Ketelaar, *Clarifying the Foundations of Evolutionary Psychology: A Reply to Lloyd and Feldman*, 13 PSYCHOL. INQUIRY 157 (2002) (replying to the critique).

228. *See, e.g.*, GEOFFREY SAMPSON, THE “LANGUAGE INSTINCT” DEBATE (rev. ed. 2005) (critically discussing and ultimately rejecting the idea that human beings have an innate “language instinct”). Note that Chomsky revised his theory more than once and that the latest version—known as the Minimalist Program—actually does away with the notion of deep structure. *See* NOAM CHOMSKY, THE MINIMALIST PROGRAM (1995); H. Lasnik, *Minimalism*, in 6 ENCYCLOPEDIA OF LANGUAGE AND LINGUISTICS, *supra* note 221, at 149–56.

to modification by legal incentives and disincentives. Second, it is useful if it can assist the law in identifying legally relevant pathological behaviors. Alas, critics claim, there is no necessary correlation between the innateness of any behavior and its plasticity, and the examples provided thus far for using the insights of evolutionary psychology to identify nonplastic, pathological behaviors are questionable.<sup>229</sup>

To the extent that it can be established that loss aversion is a universal characteristic of human psychology and that the basic features of the law described in Part II universally characterize all legal systems (or at least those systems that are sufficiently advanced to deal with the pertinent issues), these universalities lend support to theories of moral psychology.<sup>230</sup> Since the psychological findings described in Part I corroborate the first assertion and the analysis of legal norms in Part II confirms the second, my analysis indeed lends support to at least some versions of moral psychology. There may also be an evolutionary explanation for why the relative, quantitative psychological distinction between losses and gains (losses loom larger than gains, but gains do count) is translated into a sharper and more qualitative (though not absolute) moral and legal distinction between harming people and not aiding them. Given people's imperfect cognitive abilities, a general prohibition on intentionally/actively harming other people may be more adaptive than a more nuanced norm.

It should be stressed, however, that neither the general argument of this Article nor the claims made in this Section hinge on the tenets of moral psychology. Viewing commonsense morality as the connecting link between psychology and law does not presuppose the innateness of prevailing moral intuitions, nor does it rest on their universality. Even if the pertinent moral intuitions are not universal but rather characteristic of modern, western legal systems, and even if they are not innate but rather the outcome of learning and socialization, it remains true that these intuitions are very common. Thus, they can provide the link between loss aversion and the law.

---

229. Brian Leiter & Michael Weisberg, *Why Evolutionary Biology Is (So Far) Irrelevant to Legal Regulation*, 29 *LAW & PHIL.* 31, 38–49 (2010).

230. *Cf.* JOYCE, *supra* note 220, at 5 (stating that although evolutionary psychology does not necessitate cross-cultural universals, “cross-culturality can be offered as evidence of innateness in the absence of any better hypothesis indicating a universally present exogenous explanans”). *But see* Prinz, *supra* note 227, at 372 (“Humans the world over face many of the same challenges, and they have the same cognitive resources. If these two are put together, the same solutions to challenges will often arise.”).

\* \* \*

To sum up this Part, the correlation between the psychological phenomena of reference dependence and loss aversion, and basic characteristics of the law such as the tort/unjust enrichment and the takings/givings asymmetries, are not coincidental. This correlation may be the product of an evolution of judicial and statutory law given plaintiffs' stronger motivation to seek redress for losses than for unobtained gains. Primarily, though, it reflects the mindset of legal policymakers, whose moral intuitions conform to commonsense morality. Commonsense morality treats harms and benefits very differently. Just as, psychologically, losses loom larger than gains, normatively, harms loom larger than benefits.

#### IV. NORMATIVE IMPLICATIONS

##### *A. Positive and Normative Analyses*

Thus far, the focus of the discussion has been explanatory. Yet, the positive analysis of the fundamental role that reference points and loss aversion play in the law also carries important normative implications. This is not to say that one can directly derive "ought" from "is." Rather, the claim is that theories of human psychology and its interaction with the law may contribute to normative deliberation in at least two ways. First, human psychology is relevant for the construction of a normative theory. Basic elements of any normative theory, including its underlying theory of human well-being and its focal point (such as acts or rules), are founded on assumptions about human psychology.<sup>231</sup> Second, and more importantly in the present context, once a normative theory is formulated, legal policymakers aiming at a certain goal, such as the promotion of economic equality or deterrence of antisocial behavior, face pragmatic choices among different means to achieving that goal. Positive theories of human psychology and their reflection in the law may prove essential in making these choices.<sup>232</sup>

---

231. For instance, if people's actual preferences are often irrational and self-injurious, then satisfying those preferences seems a poor measure of well-being. In the same vein, a major argument favoring rule- (rather than act-) consequentialism is people's inability to accurately conduct a cost-benefit analysis in each and every case. Different theories of human welfare will be discussed in the next Section. For an analysis of possible focal points, see KAGAN, *supra* note 199, at 204–39.

232. See Adrian Vermeule, *Connecting Positive and Normative Legal Theory*, 10 U. PA. J. CONST. L. 387, 390–91 (2008) (discussing the role of factual inquires in prescriptive theories).

This Part examines various normative implications of loss aversion and its legal corollaries. It begins by justifying (rather than merely explaining) the features of the law discussed in Part II. It then explores the implications of the fact that legal norms sometimes frame, rather than just mirror, people's choices. Finally, it considers what follows from the fact that the decisions of policymakers are often reference dependent.

### *B. Justifying Basic Features of Extant Law*

The first normative implication directly refers to the basic characteristics of the law discussed in Part II. The central role that reference points and loss aversion play in people's perceptions and behavior not only explains those basic characteristics, but it may justify them as well.

All normative theories take outcomes into account, whether as the only factor that ultimately determines the morality of an act, rule, or anything else (consequentialism) or as one of several such factors (deontology).<sup>233</sup> The one type of outcome all theories deem relevant—either as the only relevant outcome (in welfarist theories) or as one of several types of pertinent outcomes (in other theories)—is the effect of any act, rule, or anything else on human welfare.<sup>234</sup> Theories of human welfare may be grouped under three large categories: hedonistic, preference-based, and objective list. According to hedonistic or mental-state theories, human well-being is determined by the presence of positive mental states, such as pleasure, and the absence of negative ones, such as pain. Under preference-satisfaction theories, well-being is enhanced to the extent that one's desires are fulfilled. The pertinent desires are those a person actually has (actual-preference theories), or those she would have had were she to calmly and rationally consider the issue, paying heed to all of the relevant information and without any external pressure, prejudice, or reasoning errors (ideal-preference theories). Finally, objective-list theories posit that well-being consists of having certain things, such as health, autonomy, and accomplishment, which are intrinsically good.<sup>235</sup>

---

233. See, e.g., JOHN RAWLS, A THEORY OF JUSTICE 26 (rev. ed. 1999) (“[D]eontological theories are defined as non-teleological ones, not as views that characterize the rightness of institutions and acts independently from their consequences. All ethical doctrines worth our attention take consequences into account in judging rightness.”).

234. KAGAN, *supra* note 199, at 30.

235. For general surveys of competing theories of well-being, see *id.* at 25–41; DEREK PARFIT, REASONS AND PERSONS 493–502 (1984).

Whichever theory of human welfare one adopts, reference points and loss aversion must be taken into account. This is patently the case under subjectivist—hedonistic and actual-preference—theories. If a loss generates greater displeasure than an unobtained gain and if people commonly prefer not losing to gaining, then any policy striving to enhance human well-being should take these phenomena into account. Arguably, this is exactly what the law does when it lays down different rules for hiring and firing in affirmative-action programs, places the burden of proof in civil litigation on the plaintiff, treats governmental takings differently from governmental givings, and so on and so forth.

The same is true under objective-list theories of human well-being. These theories do not view people's feelings or the satisfaction of actual desires as the ultimate yardsticks of welfare. However, any plausible list of objective goods includes enjoyment (experiencing pleasure and avoiding pain) and personal freedom (the ability to set one's goals and fulfill one's desires) as important features of well-being.<sup>236</sup> Hence, although objective-list theories may assign lesser weight to loss aversion (compared to mental state and preference-satisfaction theories), they too ought to take this phenomenon into account. This should particularly be the case if, as argued above, loss aversion is closely connected to emotions of pleasure and pain.<sup>237</sup>

The same argument seems to hold for ideal-preference theories of well-being. Just as experiencing pleasure and avoiding pain are elements of any plausible objective list, they are also things that people ideally desire. If losses loom larger than gains, then this factor ought to be taken into account by ideal-preference theories as well.

The last claim (as well as, to some extent, the one referring to objective-list theories) may be contested on the grounds that reference dependence and loss aversion are nothing but irrational biases. Thus, even if they typify people's actual perceptions and preferences, an ideal-preference theory should disregard them. This counterargument assumes that ideal preferences are rational, and it presupposes a particular notion of rationality, namely, expected utility maximization. That argument is, however, problematic. Nothing in expected utility theory necessitates a reference-independent utility function. Just as a utility function may reflect risk aversion, risk

---

236. Daphna Lewinsohn-Zamir, *The Objectivity of Well-Being and the Objectives of Property Law*, 78 N.Y.U. L. REV. 1669, 1703–05 (2003).

237. See *supra* notes 38–39 and accompanying text.

neutrality, or risk seeking,<sup>238</sup> it may reflect either reference independence or reference dependence. To be sure, some related aspects of decisionmaking, such as its susceptibility to framing effects and people's forecasting errors,<sup>239</sup> as well as an extreme, paralyzing aversion to losses, may indeed be deemed irrational. But as dozens of studies have shown, errors of all sorts characterize decisionmaking independent of whether one's utility function is reference dependent. Reference dependence and loss aversion are not irrational per se. If reference effects shape the experienced value of outcomes, then it is perfectly rational to take these effects into account.<sup>240</sup> Money and other resources are instrumental for attaining intrinsic goods. If the carriers of utility are not final levels of wealth, but rather gains and losses, then ideal-preference theories should not disregard loss aversion.

Three final comments are in order. First, even if there is nothing objectionable in reference dependence per se, some framings of baselines may be contestable and need not be taken as given.<sup>241</sup> Similarly, ideal-preference theories may disregard or afford lesser weight to unreasonably extreme loss aversion. Second, since both consequentialist and deontological moral theories recognize the worth of promoting human welfare, the above analysis holds for both. Third, while the above discussion used loss aversion to justify extant legal norms, it may similarly be used to critically assess existing norms and may help shape new ones. For example, loss aversion may justify deferring the application of new laws that detract from current

---

238. LEONARD J. SAVAGE, *THE FOUNDATIONS OF STATISTICS* 103–04 (2d. ed. 1972) (“[T]he law of marginal utility plays no fundamental role in the von Neumann-Morgenstern theory of utility, viewed either empirically or normatively.”).

239. See *supra* notes 20–24 and 39, and accompanying text.

240. Gregory W. Fischer et al., *Risk Preferences for Gains and Losses in Multiple Objective Decision Making*, 32 *MGMT. SCI.* 1065, 1082–83 (1986); see also ARIEL RUBINSTEIN, *LECTURE NOTES IN MICROECONOMIC THEORY* 107–11 (2006) (arguing that “the doctrine of consequentialism” (namely defining preferences over “final wealth levels”) “is not part of expected utility theory.” Rather, “the set of prizes should be the set of consequences in the mind of the decision maker. Thus it is equally reasonable to assume the consequences are ‘wealth changes’ or ‘final wealth levels.’”); Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 *J. LEGAL STUD.* 199, 220 (2006) (“[T]he endowment effect generally cannot be said to be a mistake in the sense of . . . judgment errors . . . where individuals are making objective mistakes in estimating probabilities; instead the endowment effect may be a reflection of potentially valid reasons for the difference between willingness to accept and willingness to pay.”); *infra* notes 257–58 and accompanying text.

241. See *infra* notes 256–265 and accompanying text.

entitlements so that they will only apply to people who have not yet acquired the entitlement.<sup>242</sup>

### *C. Law's Determination of Reference Points*

Experimental studies have established that the perceived reference point—determining what changes are considered as gains or losses—is sometimes unfixed and even manipulable.<sup>243</sup> Specifically, it has been demonstrated that legal norms may set the pertinent baseline for people who are subject to those norms, thereby affecting their behavior.<sup>244</sup> This finding may carry several implications.

First, it may seem to diminish the import of the Article's explanatory and justificatory project. If the law can effortlessly and effectively shape people's reference points, then preexisting baselines could just as well be ignored. This argument, however, proves too much. While people's framing is sometimes malleable, the ability of the law to frame people's perceptions varies from one context to another and is often limited. A pertinent example is tax deductions and credits. Following a powerful campaign pointing to the various pitfalls of using these measures, the federal government and most states have adopted "tax expenditures budgets" which identify and quantify tax subsidies, credits, and deductions as expenditures.<sup>245</sup> It was expected that once the true nature and problematic ramifications of tax subsidies became apparent, legislators would refrain from channeling expenditures through the tax system. This assumption was mostly proven wrong, as the use of tax expenditures has not been reduced.<sup>246</sup> Apparently, legislators and the public at large keep framing tax credits and deductions differently from direct spending.<sup>247</sup>

---

242. Cf. Ariel Porat & Omri Yadlin, *Promoting Consensus in Society Through Deferred-Implementation Agreements*, 56 U. TORONTO L.J. 151 *passim* (2006) (discussing other advantages of deferred implementation).

243. See *supra* note 20 and accompanying text.

244. See, e.g., Alberto Abadie & Sebastien Gay, *The Impact of Presumed Consent Legislation on Cadaveric Organ Donation: A Cross-Country Study*, 25 J. HEALTH ECON. 599 (2006) (finding that presumed consent legislation has a positive and sizable effect on organ donation rates); Korobkin, *supra* note 36, at 675–76 (establishing the effect of contract default rules on bargaining); Jeffrey J. Rachlinski & Forest Jourden, *Remedies and the Psychology of Ownership*, 51 VAND. L. REV. 1541, 1559–77 (1998) (presenting evidence that legal rights protected by damages do not produce the same endowment effect as rights protected by injunctive relief).

245. SURREY & MCDANIEL, *supra* note 163, at 1–30, 238–39; Zelinsky, *supra* note 162, at 803.

246. Kleinbard, *supra* note 163 (analyzing the failure of current tax expenditure budgets and recent reform proposals); Julie Roin, *Truth in Government: Beyond the Tax Expenditure Budget*, 54 HASTINGS L.J. 603, 623 (2003) (“[T]he introduction of tax expenditure budget did not markedly succeed in lowering the growth of tax expenditures.”); Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1170–81; *id.* at 1171 (“Congress has made

The same is true of takings versus givings. It may be argued that no property in land or development rights exist as long as the law does not recognize and protects them.<sup>248</sup> A possible inference from this argument is that all physical and regulatory takings and givings belong in the realm of gains. Nevertheless, it is exceedingly unlikely that the law could ever make landowners, whose land is appropriated for public use or whose existing use of the land is curtailed, view these changes as belonging in the domain of forgone gains. Perceived reference points are determined by a confluence of psychological, historical, social, and legal factors. It would be a mistake to overstate the role of the last factor.<sup>249</sup>

A second, more compelling claim rooted in the impact of legal norms on perceived reference points is a *prima facie* argument for legal conservatism.<sup>250</sup> Typically, a change in legal norms yields gains for some and losses to others. Loss aversion entails that the negative impact of a certain decrease of the losers' entitlements is likely to be greater than the positive impact of a comparable increase in the gainers' entitlements. This consideration does not necessarily block legal reforms; yet, it calls for caution. *Ceteris paribus*, a legal reform should only be pursued if the gains from changing existing norms outweigh its costs, where gains and losses are weighted differently as the latter loom larger than the former.

Being cautious in rulemaking is appropriate for another reason. Sometimes, advocates of a legal reform argue that if the reform proves to be unsuccessful or harmful, it can be undone and the preexisting legal order restored. This argument, however, underestimates the framing effect of the new legal regime once implemented. Loss aversion, the endowment effect, and the status quo

little progress in replacing tax expenditures with direct spending programs."); Zelinsky, *supra* note 162, at 801-04 (making the same observation).

247. Thuronyi, *supra* note 246, at 1172 ("[E]vidence also indicates that Congress has not taken the tax expenditure concept fully to heart. Many Members of Congress (as well as Presidents Reagan and Bush) apparently regard tax expenditure repeal not as a decrease in spending, but as an increase in taxes."); Zelinsky, *supra* note 162, at 826.

248. See, e.g., JEREMY BENTHAM, *Principles of the Civil Code*, in 1 THE WORKS OF JEREMY BENTHAM 308 (1843) (arguing that "there is no natural property . . . property is entirely the creature of law"); Morris R. Cohen, *Property and Sovereignty*, 13 CORNELL L.Q. 8, 12 (1927) ("In the world of nature . . . there are things but clearly no property rights.").

249. As the cases discussed in *supra* notes 145-51 and accompanying text (as well as innumerable others) demonstrate, a lack of formal legal entitlement does not mean that people do not reasonably develop expectations whose frustration is perceived as a loss. Very often, the law gives considerable weight to these expectations.

250. See also Stake, *supra* note 95, at 351 (arguing that loss aversion counsels for maintaining the status quo).

bias may thwart attempts to undo the legal reform once it is implemented.

Finally, once it is understood that legal norms can sometimes affect people's choices and behavior by setting the reference point, the question arises as to whether and under what circumstances such "manipulation" would be legitimate and desirable. In recent years, this question has been extensively debated under the heading of "soft" or "libertarian" paternalism: Should legal norms be used as a "nudge" to improve people's decisions regarding their own welfare?<sup>251</sup> A famous example is encouraging people to save for old age by changing the default to participation in savings plans and by adopting plans in which the savings rate increases as one's income does.<sup>252</sup> But the issue of reframing by the law goes far beyond paternalism. Framing of decisions by the law may be used to attain goals other than enhancing people's own welfare. It may be used to maximize overall social utility, as in the case of increasing cadaveric organ donations by presumed consent legislation;<sup>253</sup> or to redistribute power or wealth, as in the case of pro-consumer or pro-employee contractual default rules.<sup>254</sup>

Each and every legal measure of this kind requires an in-depth analysis of various normative and policy considerations. Elsewhere I discussed and endorsed the use of default rules as a means for ad-hoc paternalism and for the advancement of redistributive goals.<sup>255</sup> In general, regulation by reframing decisions has the important advantage of entailing lesser curtailment of people's freedom, compared to most alternatives.

In summary, the potential effect of legal norms on people's perceived baselines is a factor worth considering. Sometimes it

---

251. See, e.g., RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* (rev. ed. 2009) (advocating this type of soft paternalism); Colin F. Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism,"* 151 U. PA. L. REV. 1211 (2003) (same); Edward L. Glaeser, *Paternalism and Psychology,* 73 U. CHI. L. REV. 133 (2006) (opposing even soft paternalism); Jonathan Klick & Gregory Mitchell, *Government Regulation of Irrationality: Moral and Cognitive Hazards,* 90 MINN. L. REV. 1620 (2006) (same).

252. See Madrian & Shea, *supra* note 35 (describing the dramatic effect of changing the default regarding retirement savings); Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving,* 112 J. POL. ECON. S164 (2004) (describing the principles and robust effect of a plan in which the savings rate increases with every salary raise).

253. Abadie & Gay, *supra* note 244; see also Jolls & Sunstein, *supra* note 240, at 220–22 (arguing that, in certain contexts, it might be desirable to protect intellectual property by liability rules rather than by property rules, thereby reducing the endowment effect created by the latter and (impliedly) facilitating better utilization of intellectual property).

254. See Zamir, *supra* note 36, at 1760–62, 1782–84 (describing the endowment effect produced by contract default rules and their redistributive effect).

255. *Id.* at 1760–62, 1782–88.

militates against changing the legal status quo because the losses created by such a change loom larger than the gains. However, it can sometimes produce great improvement with very minor interference in people's freedom. In many (and probably most) cases, any attempt to change people's perceptions through the law is likely to be futile. Even when lawmakers do not strive to alter the prevailing framing of decisions, they ought to be aware that legal norms can reinforce this framing—which may or may not be desirable.

#### *D. Lawmakers' Loss Aversion*

Thus far, I focused on the normative aspects of the correlation between the law and the loss aversion of people to whom the law applies. Loss aversion and the presupposed reference dependence presumably also characterize legal policymakers, such as legislators and judges. Some studies have indeed examined the effects of framing, loss aversion, and the related phenomena of status quo bias and the endowment effect on legal decisionmaking.<sup>256</sup>

Before commenting on the normative implications of these effects, we need to address yet another aspect of the relationship between psychology and normative (moral or legal) judgments. Cass Sunstein has tentatively raised the possibility that the prevailing deontological moral convictions—of the kind offered in Part III.B as the connecting link between loss aversion and basic features of the law—are nothing but “a series of cognitive errors.”<sup>257</sup> I do not share this view. As several commentators have rightly pointed out, this conjecture fails to distinguish between two different questions. One question is which moral principles are sound (e.g., deontological or consequentialist). Another question is what the appropriate process of answering the first question is (intuitionist or deliberative). From the fact that the prevailing moral intuitions are mostly deontological, it follows neither that deliberative moral reasoning produces more sound

---

256. See, e.g., Chris Guthrie & Tracey E. George, *The Futility of Appeal: Disciplinary Insights into the “Affirmance Effect” on the United States Courts of Appeals*, 32 FLA. ST. U. L. REV. 357, 377–81 (2005) (explaining courts of appeals' tendency to affirm lower courts' judgments on the basis of the status quo and omission biases); Chris Guthrie, Jeffrey J. Rachlinski & Andrew J. Wistrich, *Inside the Judicial Mind*, 86 CORNELL L. REV. 777, 794–99 (2001) (finding that federal magistrate judges are susceptible to framing effects in assessing settlement proposals); Robert A. Prentice & Jonathan J. Koehler, *A Normality Bias in Legal Decision Making*, 88 CORNELL L. REV. 583, 638–41 (2003) (associating stare decisis and legal conservatism with the status quo and omission biases).

257. Cass R. Sunstein, *Moral Heuristics*, 28 BEHAV. & BRAIN SCI. 531, 532–34 (2005). Conceding that one can make the parallel claim that “utilitarianism is itself a heuristic, one that usually works well but leads to systematic errors,” Sunstein does not argue that deontological morality does in fact rest on cognitive errors. *Id.* at 534.

moral judgments nor that consequentialism is superior to deontology. Indeed, absolutist deontology leads to unacceptable normative judgments, such as the claim that one must not lie even to save the life of an innocent person. But so does unqualified, act-consequentialism when it justifies the killing of an innocent person and harvesting her organs to save two lives. Rigid, overgeneralized reliance on moral heuristics sometimes misfires, but so do inflexible moral principles. In fact, the most fruitful way to arrive at sound moral principles may be through a process of reflective equilibrium where both intuitions (“heuristics”) and principles play a role.<sup>258</sup>

Having rejected the notion that loss aversion is irrational *per se*<sup>259</sup> and having defended the soundness of moderate deontology elsewhere,<sup>260</sup> I do agree that questionable or objectionable framing of reference points may adversely affect legal policymaking. Cognizant of the powerful effect of reference dependence, policymakers ought to take heed of manipulative, or even innocuous, framing of decisions. They should be suspicious of strategic framing of (factual, policy, or normative) issues by lobbyists in the legislative process and by advocates in adjudication (as well as by colleagues in collective decisionmaking bodies). Moreover, conscious framing and reframing of an issue in different ways is often an eye-opening exercise. It may help challenge old truths and provide an antidote to excessive conservatism. Such reframing has been proposed and debated in such contexts as affirmative action,<sup>261</sup> taxation,<sup>262</sup> negative and positive

---

258. See Elizabeth Anderson, *Moral Heuristics: Rigid Rules or Flexible Inputs in Moral Deliberation?*, 28 BEHAV. & BRAIN SCI. 544 (2005) (rejecting Sunstein’s representation of moral heuristics as rigid and explaining their role as flexible inputs in moral deliberation); Karen Bartsch & Jennifer Cole Wright, *Towards and Intuitionist Account of Moral Development*, 28 BEHAV. & BRAIN SCI. 546 (2005) (pointing out that Sunstein fails to distinguish between the process by which moral heuristics are employed and their structure; that his critique of the latter applies equally to purely consequentialist principles; and that moral intuitions actually guard against the pitfalls of both); Barbara H. Fried, *Moral Heuristics and the Means/Ends Distinction*, 28 BEHAV. & BRAIN SCI. 549 (2005) (noting Sunstein’s problematic treatment of the relationship between moral heuristics and moral principles); see also Cass R. Sunstein, *On Moral Intuitions and Moral Heuristics: A Response*, 28 BEHAV. & BRAIN SCI. 565, 566 (2005) (“I do not suggest that moral heuristics are more likely to produce error than more systematic moral thinking of any particular sort.”).

259. See *supra* notes 238–41 and accompanying text.

260. ZAMIR & MEDINA, *supra* note 106, at 41–56.

261. See *supra* note 137 and accompanying text.

262. See, e.g., LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP* 5–11 (2002) (proposing that some conventions in taxation are sufficiently pervasive to seem like natural law, but actually those baselines should be evaluated and debated); J. Clifton Fleming, Jr. & Robert J. Peroni, *Can Tax Expenditure Analysis be Divorced from a Normative Tax Base?: A Critique of the “New Paradigm” and Its Denouncement*, 30 VA. TAX REV. 135 (2010) (discussing the crucial

constitutional rights,<sup>263</sup> governmental takings,<sup>264</sup> invalidation of unconscionable contract terms,<sup>265</sup> and job security.<sup>266</sup>

### CONCLUSION

This Article sought to explain fundamental features of the law through the psychological notions of reference points and loss aversion. It argued that basic characteristics of the law—such as the asymmetries between tort and unjust enrichment, between governmental takings and givings, between hiring and firing in affirmative action, between disgorgement and other goals of contract remedies, and between tax credits and direct governmental outlays—are best, or at least better, explained through these prevailing psychological phenomena. It then proposed two theories for the observed compatibility between human psychology and law: an evolutionary theory focusing on plaintiffs' behavior and a two-step theory based on the linkages between psychology and commonsense morality and between commonsense morality and the law, focusing on lawmakers' mindsets. Finally, the Article examined three types of normative implications of the above analysis: justifying the described features of the law, considering the implications of the role of law in framing people's perceptions, and considering policymakers' own loss aversion.

Given the ongoing, rapid accumulation of knowledge in the disciplines of cognitive psychology, economics, behavioral economics, moral psychology, evolution, and empirical legal studies, the arguments put forth in this Article must be taken with some caution. Additional experimental and empirical studies may shed more light on the pertinent issues. In addition to its explanatory and normative contributions, this Article may thus be read as an introduction to the intriguing relationships between loss aversion and the law and an invitation to further studies of these relationships.

---

role of a normative baseline tax system for tax expenditure analysis and different possibilities of such a baseline); *supra* notes 163, 245–47 and accompanying text.

263. Bandes, *supra* note 155, at 2290–93.

264. *See supra* notes 94, 248 and accompanying text.

265. Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 585–92 (1933) (proposing to view legal enforcement of contracts, rather than the refusal to enforce certain contracts or contract terms, as an exercise of the sovereign power of the state).

266. *See, e.g.*, Jack M. Beerbaum & Joseph William Singer, *Baseline Questions in Legal Reasoning: The Example of Property in Jobs*, 23 GA. L. REV. 911 (1989) (questioning the implicit baselines of the legal doctrine, the judicial reasoning, and the economic analysis of job security).