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TEXAS A&M UNIVERSITY

**Texas A&M Law Review**

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Volume 2 | Issue 2

Article 3

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2014

# Debating Law's Irrelevance: Legal Scholarship and the Coase Theorem in the 1960s

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## Recommended Citation

Steven G. Medema, *Debating Law's Irrelevance: Legal Scholarship and the Coase Theorem in the 1960s*, 2 Tex. A&M L. Rev. 159 (2014).  
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## ARTICLES

### DEBATING LAW'S IRRELEVANCE: LEGAL SCHOLARSHIP AND THE COASE THEOREM IN THE 1960S

By: Steven G. Medema\*

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#### I. INTRODUCTION

Ronald Coase's classic article, *The Problem of Social Cost*,<sup>1</sup> is widely credited with playing a significant role in the development of the economic analysis of law—one of the most influential new movements in legal scholarship in the last third of the twentieth century. The traditional history here is that this impact came via two routes: one, through the effect of Coase's article in stimulating economists to analyze issues that had traditionally been the province of legal scholars (that is, Coase as a stimulus for "economics imperialism"); and

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1. Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960) [hereinafter Coase, *Social Cost*].

two, through Coase's impact on the thinking of Richard Posner, who was moved to examine the efficiency of common law rules in part by his encounter with Coase's remarks regarding the propensity of judges to make decisions that accorded with economists' sensibilities.<sup>2</sup> While each of these historical claims is true enough, the lines of scholarship that they reference commenced only in the 1970s. The genesis of the application of Coase's insights—and, in particular, the negotiation result that came to be known as the “Coase theorem”<sup>3</sup>—to legal issues came in the first half of the 1960s, and significantly, the roots of this work lie in the *legal* community, rather than the economics community.

Economists began to work Coase's negotiation result into their analysis of externality-related market failures as early as 1962,<sup>4</sup> and it was not long before the lawyers, too, began to draw on this analysis—particularly in the realm of tort law and the determination of liability for accident-related costs. As we shall see, however, lawyers were drawing on Coase's negotiation result in other realms, as well as during the 1960s and, in the process, sowing the seeds of what was to become the economic analysis of law. Beyond this, they were talking about Coase's negotiation result, both in terms of its theoretical domain and its implications, in rather different ways than were the economists during this period—differences that reflected both the particular concerns of lawyers qua lawyers and the tensions involved in the very early stages of working out how economic thinking might inform legal analysis. This juxtaposition is indicative of the fact that Coase's negotiation result meant or implied different things to different audiences during the early stages of its diffusion into economic and legal scholarship.

In spite of the tendency to attach the Coase theorem and the birth of the economic analysis of law to the University of Chicago, the spread of the Coase theorem in legal theory is not simply a Chicago story—indeed, far from it—and even the Chicago aspects of this history are different than what one might expect. No one who has even a nodding acquaintance with the history of law and economics should dispute the notion that Yale's Guido Calabresi was the driving force behind the application of economic thinking, including the efficiency

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2. Edmund W. Kitch, *The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932–1970*, 26 J.L. & ECON. 163, 226 (1983). See also Coase, *Social Cost*, *supra* note 1, at 22.

3. The author will use the terms “Coase theorem” and “Coase's negotiation result” interchangeably here, relying mostly on the latter term. The term “Coase theorem” was not coined until 1966 and was not used in the legal literature until the 1970s. See GEORGE J. STIGLER, *THE THEORY OF PRICE* 113 (3d ed. 1966).

4. See Steven G. Medema, *Rethinking Market Failure: “The Problem of Social Cost” Before the ‘Coase Theorem’*, (Jan. 25, 2013) (unpublished manuscript) available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2188728](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2188728) [hereinafter Medema, *Rethinking Market Failure*].

criterion, to tort law during the 1960s. His lengthy debate with Walter Blum and Harry Kalven over accident law brought attention to the challenge that economic thinking posed to certain traditional legal approaches, but it also helped to move Coase's analysis onto the radar of a broad spectrum of legal scholars, since *The Problem of Social Cost* and the negotiation result were prominently referenced on both sides of this debate.<sup>5</sup>

In the pages that follow, this Article will examine the diffusion of Coase's negotiation result in the legal literature during the 1960s. In particular, the Article will focus on how the negotiation result posed a challenge for received legal thinking, how Coase's result related to far older attempts to bring economic thinking to bear on the law, how legal scholars utilized this result in their analysis, and how its treatment by legal scholars compares to that accorded it by economists during this formative stage in the Coase theorem's history. What will emerge, in the end, is an enhanced understanding of how the Coase theorem came to have a place in legal scholarship, as well as some additional insight into this neglected epoch in the history of the economic analysis of law.

## II. REVISITING COASE

*The Problem of Social Cost* is most well known for its elaboration of the negotiation result that George Stigler later christened "the Coase theorem."<sup>6</sup> Coase proposed that, viewed through the lens of economic theory, the absence of property rights over the resource in question caused the basic problem of externalities (a term that Coase despised and did not use). Using a simple, rather pastoral example of a farmer whose crops are destroyed by a neighboring rancher's roaming cattle, Coase claimed the problem was that there was no law specifying whether the farmer had the right to be free from harm or that the rancher had the right to allow his cattle to roam where they pleased.<sup>7</sup> Coase demonstrated that, once such rights were assigned, the efficient outputs of cattle and crops would obtain and that it did not matter, from an allocative perspective, whether the relevant prop-

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5. See Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961) [hereinafter Calabresi, *Some Thoughts on Risk Distribution*]; Walter J. Blum & Harry Kalven, Jr., *Public Law Perspectives on a Private Law Problem: Auto Compensation Plans*, 31 U. CHI. L. REV. 641 (1964) [hereinafter Blum & Kalven, *Public Law Perspectives on a Private Law Problem*]; Guido Calabresi, *The Decision for Accidents: An Approach to Nonfault Allocation of Costs*, 78 HARV. L. REV. 713 (1965) [hereinafter Calabresi, *The Decision for Accidents*]; Guido Calabresi, *Fault, Accidents and the Wonderful World of Blum and Kalven*, 75 YALE L.J. 216 (1965) [hereinafter Calabresi, *The Wonderful World of Blum and Kalven*]; Walter J. Blum & Harry Kalven, Jr., *The Empty Cabinet of Dr. Calabresi: Auto Accidents and General Deterrence*, 34 U. CHI. L. REV. 239 (1967) [hereinafter Blum & Kalven, *The Empty Cabinet of Dr. Calabresi*].

6. STIGLER, *supra* note 3, at 111–13.

7. Coase, *Social Cost*, *supra* note 1, at 2–8.

erty rights were assigned to the rancher or the farmer.<sup>8</sup> As Coase put it:

It is necessary to know whether the damaging business is liable or not for damage caused since without the establishment of this initial delimitation of rights there can be no market transactions to transfer and recombine them. But the ultimate result (which maximises the value of production) is independent of the legal position if the pricing system is assumed to work without cost.<sup>9</sup>

This is the result that came to be known as the Coase theorem. As set out by Coase, the result turns on two key assumptions and embodies two central results. The key assumptions are that rights are fully specified and transaction costs are zero.<sup>10</sup> The results are that the externality will be resolved efficiently (the efficiency proposition), in the sense of maximizing the value of output, and that the outcome will be invariant under alternative assignments of rights (the invariance proposition, or allocative neutrality).<sup>11</sup> Each one of these assumptions and results later became the subject of controversy.<sup>12</sup>

There were some two dozen citations to *The Problem of Social Cost* made by legal scholars during the 1960s, with the first coming in 1964—roughly three years after Coase’s article appeared in print.<sup>13</sup> The areas of legal analysis to which Coase’s article was deemed relevant ranged across automobile accidents, products liability, land-use controversies, the equitable-lien doctrine, governmental takings of private property, price regulation, landlord-tenant relationships, the allocation of the frequency spectrum, and airport congestion.<sup>14</sup> While not all of these references to Coase’s analysis were in the context of his negotiation result, a large share of them were—a fact that suggests lawyers were very quick to pick up on the potential relevance of this idea for legal reasoning.<sup>15</sup>

8. *Id.*

9. *Id.* at 8.

10. *Id.* at 15. Coase did not offer a formal definition of transaction costs, but he described them thus:

In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on.

*Id.*

11. *Id.*

12. See generally Steven G. Medema & Richard O. Zerbe, Jr., *The Coase Theorem*, in 1 ENCYCLOPEDIA OF LAW AND ECONOMICS 836 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) (discussing the debates over the theoretical validity of the Coase theorem).

13. Though carrying an October 1960 publication date, the issue of the *Journal of Law and Economics* in which Coase’s article was published did not appear until early 1961. Coase, *supra* note 1.

14. *Id.*

15. *Id.*

When Coase applied his negotiation result to a series of legal cases in *The Problem of Social Cost*, the domain of his analysis was very truncated.<sup>16</sup> His lens was trained squarely on disputes between owners of adjoining parcels of property—cases involving two parties whose use interests in their respective parcels of property were in conflict due to noise, smell, etc.<sup>17</sup> Though a handful of the invocations of Coase's negotiation result by lawyers during the 1960s were of this type, the vast majority lay elsewhere. The most frequent applications, in fact, were to automobile-accident law and products liability. In order to get at the diffusion of the Coase theorem in the legal arena, it is useful to begin with its entry point: automobile-accident law and the debate between Guido Calabresi of Yale, Walter Blum, and Harry Kalven of Chicago over the utility of applying economic analysis to this topic—a debate that brought the Coase theorem into legal scholarship.<sup>18</sup>

### III. TAKING THE COASE THEOREM FOR A DRIVE: THE EARLY ECONOMICS OF AUTOMOBILE ACCIDENT LAW

It should not surprise the reader to find that the Coase theorem entered the legal literature via the University of Chicago, but its actual source of entry into this literature has not been remarked upon in the histories of law and economics. The origin, as it happens, lies in a 1964 article on accident law, *Public Law Perspectives on a Private Law Problem*, authored by University of Chicago Law School professors Walter Blum and Harry Kalven.<sup>19</sup> Blum, whose research focused heavily on taxation, was certainly aware of the potential for economic thinking to influence legal analysis. He had taken Henry Simons's economics course in the law school while a student at Chicago during the 1940s and, along with fellow law school professors Kalven, Wilbur Katz, Malcolm Sharp, and Aaron Director (who replaced Simons as the economist on the Chicago law faculty following Simons's death in the mid-1940s), formed a small economics-related reading and discussion group—a group that at times included the participation of Milton Friedman.<sup>20</sup> And, of course, tax law had for some time had an interdisciplinary flavor in which economic reasoning played a part. Kalven seems to have been less disposed to economics than was Blum,<sup>21</sup> but Henry Manne reports that Kalven's torts class in the 1950s had a sig-

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16. *Id.* at 8–15.

17. *See generally id.*

18. *See generally* Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5; Calabresi, *The Decision for Accidents*, *supra* note 5; Calabresi, *The Wonderful World of Blum and Kalven*, *supra* note 5.

19. Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5.

20. Kitch, *supra* note 2, at 168, 179, 186.

21. This sentiment was echoed by Calabresi in a conversation with this author. Interview with Guido Calabresi (July 6, 2011) [hereinafter *Interview*].

nificant infusion of economics,<sup>22</sup> the result of an evolution in his thinking that Blum later ascribed to Kalven's participation in the reading group.<sup>23</sup> To understand how Blum and Kalven came to the application of economic analysis to questions of accident law and, in particular, to invoking Coase's negotiation result, we need to step back to examine some of the background against which their article was written—specifically, Guido Calabresi's 1961 Yale Law Journal article, *Some Thoughts on Risk Distribution and the Law of Torts*.<sup>24</sup>

Calabresi's article is well known for its proposition that the focus of tort law should move away from a fault-based liability system to one in which liability is placed on the party in the best position to avoid the harm—the case for which Calabresi attempted to ground in economic reasoning. But this move did not arise in a vacuum. Calabresi had studied economics as an undergraduate at Yale and as a Rhodes Scholar at Oxford before moving on to Yale Law School, where economics-infused legal realism had a long, if by then greatly weakened, tradition. Calabresi's economics training at Yale and Oxford included work with (then) present or future giants of the profession, such as William Fellner, James Tobin, John Hicks, and Lawrence Klein (the last three of whom would later receive the Nobel Prize in economics).<sup>25</sup> But Calabresi's interest in applying economic analysis to law was sparked in Fleming James's torts course in the law school—a course that, as he was to later remark, raised many questions of an economic nature, particularly regarding risk spreading.<sup>26</sup> James himself knew little about economics, according to Calabresi, but Calabresi found the answers to many of these questions “obvious,” given his economics training.<sup>27</sup> Calabresi took up the challenge of dealing with some of these questions from an economic perspective around 1957, when he first drafted the paper that would become *Some Thoughts on Risk Distribution and the Law of Torts* for a Yale Law Journal editorial-board competition.<sup>28</sup> It was only some years later that he offered a somewhat revised version of the paper to the journal for publication,

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22. Kitch, *supra* note 2, at 184.

23. *Id.* at 186.

24. Calabresi, *Some Thoughts on Risk Distribution*, *supra* note 5.

25. *Interview*, *supra* note 21. Calabresi had his introductory economics from Warren Nutter, who had received his Ph.D. from the University of Chicago and became one of the founders of the “Virginia School” of political economy. *Id.*

26. *Id.*

27. *Id.* The Schulman and James text utilized in James's tort course was developed in part from materials originally put together by Walton Hamilton and Schulman. See Guido Calabresi, *Neologisms Revisited*, 64 MD. L. REV. 736 (2005) [hereinafter Calabresi, *Neologisms Revisited*]; HARRY SHULMAN & FLEMING JAMES, JR., CASES AND MATERIALS ON THE LAW OF TORTS (2d ed. 1952). Hamilton, of course, was a prominent economist of the institutionalist persuasion, and it was the Hamilton link, says Calabresi, that was the source of the treatment of cost-related material in a way that suggested the relevance of economics. *Interview*, *supra* note 21.

28. *Interview*, *supra* note 21; Calabresi, *Some Thoughts on Risk Distribution*, *supra* note 5.

as a result of which it, and Coase's *The Problem of Social Cost*, were published within weeks of each other in the spring of 1961.<sup>29</sup>

A. *Calabresi and the Simple Economics of Tort Law*

Calabresi's analysis in *Some Thoughts on Risk Distribution and the Law of Torts* centered on the proposition from "traditional economic theory" that "the most desirable system of loss distribution under a strict resource-allocation theory is one in which the prices of goods accurately reflect their full cost to society."<sup>30</sup> This requirement, that the prices of goods reflect all relevant costs, is a necessary condition for allocative efficiency in the welfare economics literature.<sup>31</sup> The violation of this requirement is evidenced in various phenomena, including externalities—situations where the actions of one party impact others in a way that is not reflected in the prices faced by agents who are party to the activity—of the sort that would give rise to tort claims.<sup>32</sup> The application of this welfare principle to torts, said Calabresi, entails that the costs of a harm-causing activity be internalized to the activity causing the harm, and that the process of internalization should assign that cost to the party or to that activity that can best ensure this cost is reflected in the price of the good in question.<sup>33</sup> This insight, of course, provided the basis for the least-cost-avoider rule being advocated by Calabresi in his analysis of tort liability.

Although his 1961 article was grounded in the claim that economics could, and should, provide the basis for the allocation of accident costs, Calabresi made no bones about his sense that, in the determination of the party on whom to place tort liability in order to achieve the desired efficient outcome, "traditional economic theory is of little help."<sup>34</sup> The problem, he said, is that "*in the economist's world it often makes no difference whether, for example, the cost of an injury is put on a worker or on his employer.*"<sup>35</sup> If employers were liable for harm, they would offer the workers wage terms that were correspondingly reduced; whereas if the employees were liable, they would demand higher wages to cover the cost of acquiring insurance or of self-insuring.<sup>36</sup> "Either way," said Calabresi, the theory states that "the cost would find its way into wages and into prices."<sup>37</sup> Thus, "[f]rom the standpoint of resource allocations—though perhaps only from that standpoint—nothing would be changed" by assigning liability to one

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29. Calabresi, *Neologisms Revisited*, *supra* note 27, at 737–38; Coase, *supra* note 1.

30. Calabresi, *Some Thoughts on Risk Distribution*, *supra* note 5, at 505.

31. *See id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.* (emphasis added).

36. *Id.*

37. *Id.*



party rather than the other.<sup>38</sup> Economic analysis was unhelpful, then, because it did not provide law with any guidance for assigning liability to one party as against the other.<sup>39</sup>

The notion that the allocation of resources is not affected by the assignment of liability as between employer and employee sounds suspiciously like an application of the Coase theorem—a subject to which we shall return shortly.<sup>40</sup> For the moment, though, what bears emphasizing is that Calabresi was not willing to lend a great deal of credence to the economist's theoretical claims about the invariant effects of alternative liability assignments, labeling previous attempts to apply this theory to the context of workplace accidents as “inaccurate.”<sup>41</sup> The problem, he said, is that this theory “presupposes an all knowing, all rational economic world which does not exist.”<sup>42</sup> It goes almost without saying, of course, that this criticism anticipated an argument that would be leveled against the Coase theorem with great frequency in the coming decades. In reality, Calabresi argued, some assignments of risk do not allow for the transfer of the relevant costs into prices, parties may evaluate risk differently, and the rates at which parties are able to insure against risk may differ.<sup>43</sup> Each of these factors, in turn, will cause a variation in prices, and thus incentives, across alternative assignments of liability and will thereby give rise to outcomes that vary with the assignment of liability.<sup>44</sup>

That said, Calabresi did allow that the traditional economic view of the problem *is* relevant—that there are situations “where it actually *does not* matter who bears the loss initially.”<sup>45</sup> As examples, Calabresi cited the utilization of independent contractors and products liability cases that involve commercial buyers and sellers because these may represent situations in which each party is able to allocate the relevant

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38. *Id.* at 506 n.25.

39. *See id.* at 506.

40. In fact, economist James Chelius made exactly this connection some two decades later in an article on the influence of workers' compensation rules on safety incentives. *See generally* James R. Chelius, *The Influence of Workers' Compensation on Safety Incentives*, 35 INDUS. & LAB. REL. REV. 235 (1982).

41. Calabresi, *Some Thoughts on Risk Distribution*, *supra* note 5, at 506 & n.23 (citing economists Frank Taussig of Harvard and Harry Gunnison Brown as representative of the received view. F.W. TAUSSIG, PRINCIPLES OF ECONOMICS 326–27 (1912)). *See also* Harry G. Brown, *The Incidence of Compulsory Insurance of Workmen*, 30 J. POL. ECON. 67 (1922). Taussig's treatise was widely utilized as a textbook in the first third of the twentieth century. *See* Joseph A. Schumpeter, *Frank William Taussig*, 55 Q. J. ECON. 337, 351 (1941).

42. Calabresi, *Some Thoughts on Risk Distribution*, *supra* note 5, at 506.

43. *See, e.g., id.* (arguing that making pedestrians liable for auto-pedestrian accidents will not increase the price of cars and so will not have a deterrent effect on automobile purchases—a factor that also contributes to the accidents).

44. *See generally id.*

45. *Id.* (emphasis added).

cost to the appropriate activity or product.<sup>46</sup> He was clearly of the mind, though, that the scope for such arrangements is quite limited, and thus the traditional economic theory was not likely to apply.<sup>47</sup> In such cases, he said, the assignment of liability should *not* be a matter of indifference, and efficiency considerations dictate that the cost burden be imposed on the party who is “in a better position to allocate the cost of the particular loss to the appropriate activity or merchandise.”<sup>48</sup>

Calabresi, then, appears to have laid out his own “Coase theorem” type result at roughly the same time that Coase was making *his* point in *The Problem of Social Cost*.<sup>49</sup> Calabresi’s presentation of this result, however—as one that was well-established in the economics literature rather than as an original idea—stands in stark contrast to the incredulity and resistance with which Coase’s analysis was met in many quarters, including among economists. But Calabresi also seemed to be giving rather little scope, even in theory, to the allocative invariance result, limiting it to a far more narrow set of contexts than Coase himself was then contemplating when laying out his own analysis and certainly only a shadow of what was to come in terms of the application of Coase’s insights at the hands of others. To get additional insight into whether and how Coase’s analysis was original and the extent to which it was adding new insights to legal theory, it appears further exploration is needed.

### B. Questioning Coase at Chicago

It is not widely appreciated that the first citation to *The Problem of Social Cost* and Coase’s negotiation result to emerge from the University of Chicago economics faculty did not occur until October 1964, when Harold Demsetz published an article on *The Exchange and Enforcement of Property Rights* in the *Journal of Law and Economics*.<sup>50</sup> The first reference to *The Problem of Social Cost* and Coase’s negotia-

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46. See *id.* at 545–47. Calabresi even allowed that this reasoning may apply to modern “workmen’s compensation” situations, given the development of strong labor unions in some industries and the potential that they could function as more effective bargaining units than could individual workers. *Id.* at 506 n.25.

47. *Id.* at 545–48.

48. *Id.* at 506–07.

49. See generally Calabresi, *Some Thoughts on Risk Distribution*, *supra* note 5; Coase, *Social Cost* *supra* note 1. Of course, Coase had argued this point already in 1959, which led to the writing of his 1960 article. See Ronald H. Coase, *The Federal Communications Commission*, 2 J.L. & ECON. 1 (1959) [hereinafter Coase, *The Federal Communications Commission*]. See, for example, STEVEN G. MEDEMA, *THE HESITANT HAND: TAMING SELF-INTEREST IN THE HISTORY OF ECONOMIC IDEAS* (2009); Kitch, *supra* note 2 for a discussion of the relationship between *The Federal Communications Commission* and *The Problem of Social Cost*. Calabresi, however, had not seen either of Coase’s articles prior to penning his own piece. *Interview*, *supra* note 21.

50. Harold Demsetz, *The Exchange and Enforcement of Property Rights*, 7 J.L. & ECON. 11, 12 n.1 (1964).

tion result to come out of the law school, however, actually occurred several months earlier, in Walter Blum and Harry Kalven's article, *Public Law Perspectives on a Private Law Problem: Auto Compensation Plans*. This article was published in the *University of Chicago Law Review* in the summer of 1964 and was based on the Schulman Lectures that they delivered at Yale in February of that year.<sup>51</sup> Coase himself did not arrive at the University of Chicago until 1964,<sup>52</sup> having twice in the previous decade turned down offers to move there—first from the University of Buffalo and then from the University of Virginia.<sup>53</sup> Given this timeline, the early diffusion of Coase's negotiation result at Chicago cannot be explained by Coase's presence on the faculty and instead would seem to owe to the attractiveness of, or challenge posed by, this idea and the felt need to take it and its implications into account when thinking about externality-related economic and legal problems.

Blum and Kalven's larger goal in *Public Law Perspectives on a Private Law Problem* was to "explor[e] the underlying rationale of tort liability and compensation schemes," with automobile accident law providing a "test" for their theory against other contenders.<sup>54</sup> Blum and Kalven's preferred approach to the problem reflected their respective backgrounds: Kalven, the professor of tort law and co-author of a textbook on the subject,<sup>55</sup> and Blum, the professor of tax law, were advocating a structure that would combine a tort liability system with a system of social insurance that provided compensation for accident victims.<sup>56</sup> Such a system, they argued, would have the effect of holding liable those whose actions caused the accidents while providing full and swift compensation to accident victims.<sup>57</sup>

While evaluating how their proposed system stacked up against alternative standards and systems, Blum and Kalven took up the question of how the economist would approach the question of liability and compensation for accidents, noting that it had become a "fashionable" perspective from which to examine these issues.<sup>58</sup> This, of

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51. Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5, at 641 n.1, 699 n.130. Shulman, of course, was the co-author of the textbook from which Calabresi had learned tort law under Fleming James. *See supra*, note 27 and accompanying text.

52. Kitch, *supra* note 2, at 212.

53. *Id.* at 219.

54. Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5, at 642.

55. CHARLES O. GREGORY & HARRY KALVEN, JR., *CASES AND MATERIALS ON TORTS* (2d ed. 1959).

56. Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5, at 722.

57. *Id.* In contrast, a rule such as negligence, by awarding compensation only if the other party was negligent, would not provide compensation for many accidents, and even then only with a long delay as the case wound its way through the legal system.

58. *Id.* at 692.

course, brought them squarely into conflict with Calabresi's economic arguments for a least-cost-avoider rule, but it also led them to bring Coase's negotiation result directly into the discussion—and in a way that sheds some light on the questions related to the originality of Coase's contribution and its relation to Calabresi's analysis, noted above.<sup>59</sup>

Like Calabresi, Blum and Kalven associated the economic approach to the problem with the question of efficiency, here taken to mean that all relevant costs are reflected in prices. Such prices ensure that agents will make appropriate choices with regard to the goods and services they produce or consume, and that these goods and services are produced in the most efficient manner.<sup>60</sup> To analyze how economics would apply to questions of liability, they instanced a situation in which the face of a wristwatch dial contains radioactive material that causes skin damage to some individuals who wear these watches.<sup>61</sup> The economist, they suggested, would assess the liability question by pointing to impacts: if the manufacturer is not made liable for this harm, the consumer will bear the costs.<sup>62</sup> If, on the other hand, the watch manufacturer is made liable for damage, the increased costs to the manufacturer will be translated into higher prices, meaning the consumer will bear the cost in the end.<sup>63</sup> That is, the economist would argue that the assignment of liability has no impact on the allocation of costs, making it a matter of indifference, from an efficiency perspective, who is made liable.<sup>64</sup> Like Calabresi, Blum and Kalven found the economist's analysis of the problem of little use when it came to guiding decisions regarding the assignment of liability.<sup>65</sup> But they also joined Calabresi in contending that the economist's story regarding invariant allocations will not always translate well into real-world situations, owing to the problems with mapping the frictionless world of economics onto the real world.<sup>66</sup>

For Blum and Kalven, even granting the applicability of the economist's logic to the watch-dial case did not resolve the issue at hand.<sup>67</sup> The problem, they argued, is that this logic does not translate well to automobile accidents, where, unlike in the watch-dial case, not all of the involved parties are in an existing market or bargaining relationship, and thus not all costs get translated into prices faced by the relevant parties.<sup>68</sup> Auto-pedestrian accidents, they pointed out, are the

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59. *Id.* at 699–706.

60. *Id.* at 695–96.

61. *Id.* at 696.

62. *Id.* at 696–97.

63. *Id.*

64. *Id.*

65. *Id.* at 697–98.

66. *Id.* at 698–99.

67. *Id.*

68. *Id.*

consequence of the actions of both parties.<sup>69</sup> But if liability is placed on victims, the costs to pedestrians who do not own cars will not be transferred into the marketplace for automobiles and driving-related activities. Also, placing liability on drivers will not lead to increased costs for pedestrians.<sup>70</sup> As such, agents could not be expected to adjust their behavior in ways that would generate the efficient results contemplated by the economist.<sup>71</sup> Even in the case of accidents caused by automobile defects, they noted, the existence of a bargaining relationship between manufacturer and consumers is not sufficient to efficiently transfer costs into prices, given that the class of accident victims goes well beyond purchasers of automobiles (to include, e.g., pedestrians).<sup>72</sup> Blum and Kalven were thus led to conclude that it may well make a difference, from an efficiency perspective, where liability is assigned.<sup>73</sup> But the further problem that arises in these cases, they said, is that economics cannot tell us whether assigning liability to drivers or victims will result in a smaller distortion.<sup>74</sup>

All of this, said Blum and Kalven, would seem to leave us at “an impasse where we cannot use the economist’s criteria to resolve our liability issue.”<sup>75</sup> It was at this point, however, that they suggested that “[r]ecent economic theorizing, associated with the name of Ronald Coase, might alter the picture.”<sup>76</sup> Coase, they said, had challenged the long-held assumption that “in the situations where law had a choice of placing a cost on an activity or of leaving it as an externality to that activity, the decision would inevitably affect the allocation of resources.”<sup>77</sup> His insight, as they interpreted it, was as follows:

Coase has argued that if the actors and victims—that is, the relevant parties—are free to negotiate with each other and there are no inhibiting costs in bargaining, the result of these negotiations will be the same allocation of resources regardless of where the law places the cost.<sup>78</sup>

The implication of this, according to Blum and Kalven, was that *any* tort situation becomes akin to the watch-dial example, meaning that

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69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.* Unlike Calabresi, Blum and Kalven made no references to the economics literature here. Indeed, the only references to the economics literature in their article are to Coase’s *The Problem of Social Cost* and to a working paper by University of Chicago economist Simon Rottenberg—the latter reference going to issues of incentives and efficiency in the legal realm. *Id.* at 699 n.130, 702 n.134.

75. *Id.* at 699.

76. *Id.*

77. *Id.* at 699–700.

78. *Id.* at 700.

“[i]nsofar as [Coase’s] analysis holds, . . . the law cannot make a serious mistake in an economic sense in its choice of liability rule.”<sup>79</sup>

But Blum and Kalven *still* could not get fully on board with the economist’s prescription. The problem with Coase’s analysis, they argued, was once again the collision between economic theory and reality—that the negotiation result is unlikely to apply to auto accident situations.<sup>80</sup> Specifically, they said, “[i]t is extremely awkward to imagine motorists and potential victims negotiating about their patterns of activity, and it would seem near fantasy to imagine what the terms of any bargain between them might be.”<sup>81</sup> As a result, they concluded, we cannot assume that, whatever decision is made by the courts, the result will be an outcome that generates the efficient allocation of resources.<sup>82</sup>

It is worthwhile to step back at this point and consider why Blum and Kalven invoked Coase’s negotiation result in the case of auto accidents but not in the watch-dial example, which, on the face of it, appears to be more or less identical.<sup>83</sup> Though Blum and Kalven did not take up this subject explicitly,<sup>84</sup> the answer seems to lie in the contexts in which the two tort situations emerge. In the watch-dial case, the context is that of an established market between buyers and sellers of a product—in this case, watches—where, according to a half-century of economic theory, prices will adjust to take account of factors germane to the cost or valuation of the good, including all costs associated with its production.<sup>85</sup> Buyers and sellers here interact within a forum, the market, that allows for costs to be registered in the marketplace. Consumers demand lower prices when they are forced to bear costs associated with product-related harms, and sellers charge higher prices when liability falls on them.<sup>86</sup> The effect, in the end, is that the net prices paid by buyers and received by sellers are identical across the alternative assignments of liability—at least in theory.<sup>87</sup>

In the case of auto accidents, however, there is no regularized mechanism—akin to the function performed by the market in the watch-dial example—for many of the potential accident costs to be

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79. *Id.* at 696, 700.

80. *Id.* at 700.

81. *Id.*

82. *See id.* at 701–02.

83. *Id.* at 696.

84. *See* further discussion of Calabresi *infra* pp. 173–75.

85. Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5, at 696–97.

86. The market logic here is no different from that which explains why a home with an ocean view will sell for a higher price than an identical home situated two blocks inland.

87. George Stigler was to note two years later that this “Coase theorem” result is no different than that of the incidence of a sales tax, which, in theory, is identical regardless of whether the tax is formally levied on buyers or sellers. *See* STIGLER, *supra* note 3, at 113.

translated into prices.<sup>88</sup> What Coase had shown, according to Blum and Kalven, was that parties not directly linked through the marketplace could potentially negotiate efficient agreements related to the costs of harmful acts, and that the resulting outcomes would not be affected by the associated liability regime in the shadow of which the negotiation took place.<sup>89</sup> In the case of auto accidents, however, such negotiations are problematic, as noted above, and this led Blum and Kalven to conclude that allocation will indeed be impacted by the court's decision on liability.<sup>90</sup>

Blum and Kalven's hesitancy about what economics can or should add to law went well beyond finding Coase's negotiation result problematic. For example, they questioned whether the "prices" imposed by legal rules serve a deterrent function and whether efficiency (as opposed to "justice," traditionally conceived) is an appropriate goal for law.<sup>91</sup> But for present purposes, what is germane is that Blum and Kalven were willing to countenance the application of Coase's result to legal analysis, even if they found it wanting in the end when it came to the subject of automobile accidents.

What remains unclear in all of this is *why* Blum and Kalven were led to invoke Coase's analysis in the first place. Unfortunately, neither Blum and Kalven's text nor the archival evidence has yielded any clues.<sup>92</sup> Though Coase had not yet arrived at Chicago,<sup>93</sup> it could well be that his argument was "in the air" around the law school during this period, and Blum and Kalven may have realized the potential to connect Coase to this line of reasoning after reading Calabresi's remarks about the economist's long-established views on the invariant effects of alternative liability rules in the marketplace. What is interesting about Blum and Kalven's discussion, though, is not simply that they brought Coase's analysis into the story, but that they were willing to make a leap beyond what Coase had done, in that Coase's analysis was confined to conflicting-use cases where the parties involved were in constant and close proximity to one another—a very different context than that associated with automobile accidents.<sup>94</sup> What led Blum and Kalven to make this contextual leap? At this point, unfortunately, we can do little more than conjecture.

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88. See Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5, at 698–99.

89. *Id.* at 700.

90. *Id.*

91. *Id.* at 700–01.

92. See generally Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5.

93. Kitch, *supra* note 2, at 212.

94. See generally Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5.

### C. Calabresi Redux

Blum and Kalven's discussion, then, provides some insight into the questions of whether and how Coase's negotiation analysis offered something new to the law<sup>95</sup> and into the attendant question of whether Calabresi's 1961 article, in effect, offered its own "Coase theorem," albeit as a well-established result rather than a new theory.<sup>96</sup> Some further insight into these issues, and into Calabresi's rationale for limiting the achievement of efficient and invariant allocations to accidents involving independent contractors and certain products liability situations, can be found in his 1965 article, *The Decision for Accidents: An Approach to Nonfault Allocation of Costs*, published in the *Harvard Law Review*.<sup>97</sup>

It was in *The Decision for Accidents* that Calabresi first brought Coase's analysis into his own discussion and, at the same time, clarified what had been only implicit in Blum and Kalven and in his own discussion of market solutions in *Some Thoughts on Risk Distribution and the Law of Torts*.<sup>98</sup> In *The Decision for Accidents*, Calabresi emphasized that what allows markets to, in theory at least, deal satisfactorily with harmful effects in certain contexts—e.g., workers' compensation or products liability—is the presence of a *pre-existing or ongoing contractual relationship* that can be modified to account for the harmful effect or the potential for one.<sup>99</sup> The underlying intuition here is that where a marketplace relationship *already* exists, the forces of supply and demand will work to internalize the relevant costs associated with the risk of accidents, and there is scope—in theory at least—for the market to generate an efficient and invariant result.<sup>100</sup> But again, this was an insight that, as Calabresi emphasized, had long been recognized in the economics literature.<sup>101</sup>

In bringing Coase into the story, however, Calabresi ascribed to him the insight that the *same* efficiency and invariance results that we observe in "bargaining situations" (Calabresi's term for the pre-existing bargaining relationship) can emerge from the much wider class of situations in which *no* pre-existing market or contractual relationship obtains—as in the case of automobile accidents.<sup>102</sup> Calabresi's interpretation of Coase's insight is worth quoting in full:

Recently, it has been ably argued that the same reasoning may apply in a great variety of situations in which a bargaining or contractual relationship does not exist between the potential original

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95. *Id.* at 700.

96. *Id.* at 706.

97. Calabresi, *The Decision for Accidents*, *supra* note 5.

98. *Id.*; Calabresi, *Some Thoughts on Risk Distribution*, *supra* note 5.

99. Calabresi, *The Decision for Accidents*, *supra* note 5, at 725–32.

100. *See id.*

101. *See id.* at 717–18.

102. *Id.* at 729.



bearers of the accident cost. The argument runs that if the cost of a factory-smoke nuisance, for instance, is put on the homeowner rather than on the factory, and the cheapest way to avoid this cost is not for the homeowner to move or wear a gasmask but is for the factory to install a smoke-clearing device or cut down production, the homeowner will pay the factory to do this. On the other hand, if the cost is originally put on the factory, and the best way to minimize the loss is to get the homeowners to move, the factory will find it cheaper to pay for such a move rather than to cut down production. Either way, it is argued, the market will find the cheapest way to deter or minimize the loss. And while there may be some difference in the end as to who is richer and who is poorer, in terms of general cost deterrence the same results will be achieved whoever bears the initial loss.<sup>103</sup>

What Coase had shown, so far as Calabresi was concerned, was that “a bargaining relationship can *always* be established” between the party on whom the loss originally falls and the party who is best positioned to minimize the loss, and that “[i]n a perfect world such a bargaining relationship will always result in appropriate minimization of the loss,” just as in the case of the pre-existing bargaining relationship.<sup>104</sup>

That said, the possibilities associated with actually *applying* Coase’s analysis to the context of accidents apparently were sufficiently remote for Calabresi in 1965 that he did not attempt to offer an illustration of a situation in which Coase’s negotiation result might be put to use, even in theory.<sup>105</sup> Instead, Calabresi turned immediately to an elaboration of what he saw as the *problems* associated with making use of Coase’s result, placing particular emphasis on the cost of establishing a market/bargaining relationship in the first place, and on free-riding behavior that he felt was likely to emerge in such contexts.<sup>106</sup>

The practical problems associated with working out Coasean solutions were not Calabresi’s only concern, however.<sup>107</sup> He also thought that he had spotted a logical flaw in Coase’s analysis.<sup>108</sup> Though Calabresi was on board with Coase’s negotiation result as far as it went, it was not clear to him that Coase’s efficiency and invariance claims would hold up in the long run.<sup>109</sup> The issue, he said, is that, in the long

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103. *Id.*

104. *Id.* at 730 (emphasis added) (footnote omitted). See also Guido Calabresi, *Changes for Automobile Claims? Views and Overviews*, 1967 U. ILL. LEGAL F. 600, 607 (1967) [hereinafter Calabresi, *Changes for Automobile Claims?*] (stating that Coase had shown, “in theory, any ‘independent’ situation can be transformed into a bargaining situation”). It is worth noting that Coase himself had made no reference to those situations where a bargaining relationship already exists, and it was Calabresi who first pointed out the essential similarity between this older result and Coase’s insight.

105. *But see* Calabresi, *Changes for Automobile Claims?*, *supra* note 104, at 607–08.

106. Calabresi, *The Decision for Accidents*, *supra* note 5, at 730–31.

107. *Id.* at 730 n.28.

108. *Id.*

109. *Id.*

run, the different flows of payments that accompany alternative assignments of liability will affect relative profits and thereby the incentives for entry into and exit from those industries in the long run.<sup>110</sup> If, for example, manufacturers were held liable for damage caused to farmers by the pollution of water used for irrigation, these higher costs for manufacturers would reduce manufacturing profitability relative to that in farming, meaning that resources would flow out of manufacturing and perhaps also into farming.<sup>111</sup> The converse would be true if the farmers were liable for the harm.<sup>112</sup> These entry and exit effects, in turn, would alter relative goods prices, the effect of which would be to generate asymmetric levels of output across alternative assignments of liability—thereby negating Coase's invariance claim.<sup>113</sup> Moreover, the fact that these new output levels would diverge from the original efficient-negotiated outputs suggested to Calabresi that Coase's efficiency claim could not be sustained, either.<sup>114</sup>

This critique required some thoughtful engagement with the economic theory underlying Coase's negotiation result—something other legal scholars and precious few economist commentators had cared to undertake to this point<sup>115</sup>—and reinforces our sense that Calabresi took the negotiation result quite seriously as a proposition with some bearing on legal issues rather viewing it simply as a theoretical curiosity. And, as we have already seen, Calabresi's economics training had not blinded him to the practical problems involved in moving from the frictionless world of economic theory to the imperfect market and exchange relationships of (legal-)economic reality. The force of these imperfections, both in the pre-existing bargaining case and in Coasean situations of independent agents, combined with his concerns about the long-run logic of Coase's negotiation result, led Calabresi to conclude that, “for both theoretical and practical reasons, . . . there are many situations in which we cannot assume that it makes no difference, in terms of accident deterrence, who is saddled with the original liability.”<sup>116</sup> This sense is confirmed by Calabresi in his critique of

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110. *Id.*

111. *See id.*

112. *See id.*

113. *Id.* The entry/exit critique gained some currency among economists, who raised this issue independently in the mid-1960s. *See, e.g.,* David F. Bramhall & Edwin S. Mills, *A Note on the Asymmetry Between Fees and Payments*, 2 *WATER RESOURCES RES.* 615, 616 (1966). Bramhall and Mills built their challenge on a similar one laid down in Morton Kamien, Nancy L. Schwartz, & F. T. Dolbear, *Asymmetry Between Bribes and Charges*, 2 *WATER RESOURCES RESEARCH* 147 (1966). David F. Bramhall & Edwin S. Mills, *A Note on the Asymmetry Between Fees and Payments*, 2 *WATER RESOURCES RES.* 615, 615 (1966).

114. Calabresi, *The Decision for Accidents*, *supra* note 5, at 730 n.28.

115. The exception on the critic front was Columbia University economist Stanislaw Wellisz. *See* Stanislaw Wellisz, *On External Diseconomies and the Government-Assisted Invisible Hand*, 31 *ECONOMICA* 345 (1964).

116. Calabresi, *The Decision for Accidents*, *supra* note 5, at 731.

Blum and Kalven, published several months after *The Decision for Accidents*, where he noted that one area in which they seemed to be in agreement was in feeling that the “practical limitations” attending bargains of the type envisioned by Coase “are significant enough to preclude their being the answer.”<sup>117</sup> It is safe to conclude, then, that, circa 1965, Calabresi was of the mind that Coase’s analysis had added little, if anything, to the discussion of practical accident remedies.

Even so, Calabresi was disappointed that Coase’s result, which he labeled “ingenious,” could not be put to practical use.<sup>118</sup> This was *not* because, were Coase’s negotiation result applicable, we could then be indifferent about assignments of liability. Indeed, Calabresi was *never*, even in theory, indifferent about assignments of liability. Instead, his thinking was more instrumentally oriented: his view was that “were Coase’s theory frequently workable, the guidelines for liability derived in the [pre-existing] bargaining case”—factors such as which party is the better risk bearer or which party can insure more cheaply against liability—“would apply here as well.”<sup>119</sup> The reasoning behind this statement becomes clear when one realizes that, in Calabresi’s world, getting to efficiency is a multi-step process. The first step is to assign liability to those parties (that class of agents—drivers, pedestrians, etc.) who can most cheaply internalize the relevant costs—i.e., the least-cost avoiders.<sup>120</sup> The second step is that these costs must be translated into the prices faced by all agents so that they can appropriately adjust their behavior.<sup>121</sup> On Calabresi’s reading, what Coase had provided was the key to unlocking this second step in the absence of an existing bargaining/market relationship: the establishment of liability allows for the creation of a market framework for interaction that was not previously present.<sup>122</sup> But if the costs of establishing such a market are too high, as Calabresi expected they generally would be, there is no mechanism for transmitting the relevant costs into each of the prices faced by each of the affected parties, and as a result, the costs are not internalized in a way that will generate efficient outcomes.<sup>123</sup> If the establishment of liability ensured the creation of a bargaining relationship, then the transference of costs into price would also be ensured. In such circumstances, the only issue for efficiency would be to ensure that liability is assigned to the party who

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117. Calabresi, *The Wonderful World of Blum and Kalven*, *supra* note 5, at 231 n.28. That the dispute between Blum and Kalven on the one hand and Calabresi on the other did not go to the validity of Coase’s negotiation result is reflected in Blum and Kalven’s 1967 rebuttal to Calabresi. See Blum & Kalven, *The Empty Cabinet of Dr. Calabresi*, *supra* note 5, at 264 n.53.

118. Calabresi, *The Wonderful World of Blum and Kalven*, *supra* note 5, at 231.

119. *Id.* at 231 n.28.

120. *Id.* at 232.

121. *Id.*

122. *Id.* at 231–32 n.28.

123. *Id.* at 232.

can internalize the harm at lowest cost—toward which the above-enumerated factors would provide guidance, just as in the case of a pre-existing bargaining relationship.<sup>124</sup> But alas, Calabresi considered this prospect extremely remote.<sup>125</sup>

The reader may well be perplexed by the fact that Calabresi did not seem to follow Coase here in allowing that *any* assignment of liability will generate an efficient outcome—that is, why Calabresi felt it necessary to assign rights to the least-cost avoider when Coase had argued that efficiency is guaranteed in any case. The answer goes to a significant distinction between the contexts within which Calabresi and Coase were conducting their respective analyses. When closely reading Calabresi's discussion of tort remedies, including Coasean solutions, one thing that stands out is that his discussion was consistently conducted on a large numbers/market level. Calabresi's "Coase theorem" was not one that involved, or at least focused on, the two-party, bilateral-exchange context of Coase's farmer and cattle rancher or of the physician and the confectioner in *Sturges v. Bridgman*, where the two agents negotiate an efficient and invariant outcome in the shadow of the law regardless of how rights are assigned.<sup>126</sup> Instead, the parties involved are the *class* of injurers and the *class* of victims, as seen most prominently in his discussions of automobile manufacturers, drivers and pedestrians, farmers and cattle ranchers, and the like.<sup>127</sup> Calabresi was speaking of the possibilities and problematics of the internalization of accident costs within a *market* process involving these classes of agents, and his quest was for legal rules that would internalize costs to the relevant class(es) of actors in a way that minimizes accident-related costs.<sup>128</sup>

This, then, brings us to the crux of Calabresi's interest in Coase's result and, indeed, *his* conceptualization of Coase's insight in *The Problem of Social Cost*: for Calabresi, Coase's analysis said that where

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124. *Id.* at 226.

125. *Id.*

126. *Sturges v. Bridgman*, (1879) 11 Ch.D. 852, (1883), 32 Reports of Cases Decided by the English Courts 837.

127. See generally Calabresi, *Some Thoughts on Risk Distribution*, *supra* note 5; Calabresi, *The Decision for Accidents*, *supra* note 5; Calabresi, *The Wonderful World of Blum and Kalven*, *supra* note 5.

128. See Calabresi, *The Wonderful World of Blum and Kalven*, *supra* note 5, at 231. There is one other interesting point of departure between Calabresi and Coase at this stage. Whereas Coase assumed that transacting was costless in formulating his negotiation result, Calabresi presents the reader with a Coasean framework within which "the cost of establishing such relationships is *not too great*"—that is, he allowed for non-zero costs of transacting. See *id.* at 231 n.28. This, of course had the effect of adding a dose of realism to Coase's original result, given that the costs of transacting in the real world are always positive. But it had the problematic aspect of being incorrect, in the sense that an invariant outcome is not assured (or even likely) if transaction costs are non-zero. We must bear in mind, however, that all of this was very early in the history of the discussions of the Coase theorem, and the notion of transaction costs, their nature, and their impact was still very much in its infancy.

a market does not exist to internalize costs, the assignment of liability will have the effect of creating a set of market or market-like interconnections between classes of agents that will cause relevant costs to be reflected in the prices faced by all agents—in the case of automobiles, for example, all drivers and all pedestrians.<sup>129</sup> It was a theoretical complement to the pre-existing-bargaining-relationship situations, e.g., products liability and workers' compensation—one that ensured that the proper legal regime would internalize expected costs to all potential injurers and potential victims in a way that would minimize the cost of accidents. Unfortunately, though, this result was, for Calabresi, little more than an interesting fiction.

D. *From Interesting Fiction to Useful Fiction: Calabresi's Resurrection of Coase*

Even with his extensive economics background, however, Calabresi did not quite get it right in his 1965 entry/exit-based challenge to Coase's analysis, as he himself admitted in a brief article on this subject, *Transaction Costs, Resource Allocation, and Liability Rules—A Comment*, published in the *Journal of Law and Economics* in 1968.<sup>130</sup> On what basis did Calabresi retract his earlier criticism of Coase's negotiation result? In essence, he invoked the Coase theorem in defense of the Coase theorem by arguing that “the same type of transactions which cured the short run misallocation would also occur to cure the long run ones.”<sup>131</sup> If, after entry and exit effects, the output of one industry—say, farming—is too low, relative to the other—say, manufacturing—“those who lose from this ‘misallocation’ would have every reason to bribe farmers to produce more and factories to produce

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129. See Calabresi, *The Decision for Accidents*, *supra* note 5, at 730–31. This large-numbers/small-numbers distinction explains other aspects of Calabresi's analysis as well, including his emphasis on the costs of establishing a market and on the prospect of free-riding within the negotiation process. Neither of these issues is relevant to Coase's bilateral bargaining situation. See Calabresi, *The Decision for Accidents*, *supra* note 5, at 730–31; Calabresi, *The Wonderful World of Blum and Kalven*, *supra* note 5, at 231 n.28; Guido Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 *J.L. & ECON.* 67, 68 n.5 (1968) [hereinafter Calabresi, *Transaction Costs*]. Calabresi was well aware of the fact that his conception of transaction costs, with its emphasis on the costs of establishing a market, differed significantly from that of Coase (who focused on the costs associated with the negotiation process itself), though he never made a connection between their respective emphases and the distinction between the large-numbers character of his own analysis and the small-numbers character of Coase's. See Calabresi, *Transaction Costs*, *supra* note 129, at 68 n.5; Coase, *Social Cost*, *supra* note 1, at 15.

130. Calabresi, *Transaction Costs*, *supra* note 129. By this time, the *Journal of Law and Economics* was being edited by Coase. See, e.g., Ronald H. Coase, *Ronald H. Coase—Biographical*, NOBELPRIZE.ORG, [http://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/1991/coase-bio.html](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1991/coase-bio.html) (last visited Oct. 1, 2014). Calabresi thanked both Coase and his Yale Law School colleague, Ward Bowman, himself a Chicago product, for discussions related to various aspects of this note. Calabresi, *Transaction Costs*, *supra* note 129, at 67 n.\*.

131. Calabresi, *Transaction Costs*, *supra* note 129, at 67.

less,” a process that, he said, would continue until the misallocation had been fully corrected.<sup>132</sup>

However, Calabresi was not content to stop at this. Instead, he pushed the envelope even further by claiming that, at least in theory, Coase’s negotiation result has applicability going well beyond externalities.<sup>133</sup> What Coase’s analysis showed, he said, was that “if one assumes rationality, no transaction costs, and no legal impediments to bargaining, *all* misallocations of resources would be fully cured in the market by bargains.”<sup>134</sup> That is, in a Coase-theorem world, there will be no inefficiencies whatsoever; ostensible market failures will always be efficiently resolved via bargaining between affected parties, whatever their number and the context of the problem.<sup>135</sup>

Having recanted his earlier charge against the Coase theorem, Calabresi proceeded to offer his most penetrating insight into the theorem to date, one that could be considered either laudatory or damning, depending on one’s perspective, and is worth quoting at length:

Far from being surprising, this statement is tautological, at least if one accepts any of the various classic definitions of misallocation. These ultimately come down to a statement akin to the following: A misallocation exists when there is available a possible reallocation in which all those who would lose from the reallocation could be fully compensated by those who would gain, and, at the end of this compensation process, there would still be some who would be better off than before.<sup>136</sup>

However, he continued:

This and other similar definitions of resource misallocation merely mean that there is a misallocation when a situation can be improved by bargains. If people are rational, bargains are costless, and there are no legal impediments to bargains, transactions will *ex hypothesis* occur to the point where bargains can no longer improve the situation; to the point, in short, of optimal resource allocation. We can, therefore, state as an axiom the proposition that all externalities can be internalized and all misallocations, even those created by legal structures, can be remedied by the market, except to the extent that transactions cost money or the structure itself creates some impediments to bargaining.<sup>137</sup>

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132. *Id.* at 67–68. It should be noted that economists continued to debate for some time whether there were other valid reasons why the entry/exit critique was legitimate. See, e.g., Medema & Zerbe, *supra* note 12, at 842–43 (discussing the entry/exit critique).

133. Calabresi, *Transaction Costs*, *supra* note 129, at 68.

134. *Id.* at 68 (emphasis added).

135. University of Chicago economist Harold Demsetz made a nearly identical claim in the *Quarterly Journal of Economics* that same year. See Harold Demsetz, *The Cost of Transacting*, 82 Q.J. ECON. 33, 33 (1968).

136. Calabresi, *Transaction Costs*, *supra* note 129, at 68.

137. *Id.*

Calabresi was the first, but by no means the last, to label the Coase theorem a tautology.<sup>138</sup>

In Calabresi's hands, though, the theorem was a *useful* tautology, and he managed to find real-world utility and applicability in Coase's result, in spite of his own overall pessimism about the feasibility bargaining solutions. Indeed, Calabresi identified three areas in which he believed that Coase's negotiation result could inform legal thinking and decision making—one of which was a positive insight and two of which were normative in nature.<sup>139</sup>

The first of these went to one of the concerns that preoccupied Calabresi throughout his discussions of accident law: the prospect that judges may misidentify the least-cost avoider and allocate costs to the wrong activity.<sup>140</sup> Calabresi believed that Coase's negotiation analysis provided a potential remedy in such situations: Coase-theorem-like negotiations have the potential to correct errors in the assignment of liability.<sup>141</sup>

But the possibilities of the market did not end there. Calabresi was also of the mind that assignments of liability informed by Coase's insight could aid this self-correcting process, and it is here that Calabresi put a normative spin on the issue.<sup>142</sup> If, as will often be the case, we are uncertain about which party is the least-cost avoider, he said, the operative question becomes: "Which mistaken allocation can be cured most cheaply by parties entering into transactions with each other in the market?"<sup>143</sup> The rule that emerges from this line of thinking, for Calabresi, is that, unless we are quite certain which of the parties is the least-cost avoider, "we should put the burden on the party which can cure a mistake most cheaply if one has been made, and thus help the market to operate as effectively as possible."<sup>144</sup> And, as he noted a year later in 1968, "This amounts to the following injunction: when in doubt, allocate the cost to the party who can most cheaply enter into transactions to rectify the error."<sup>145</sup> In setting forth this prescrip-

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138. *Id.* Calabresi also referred to Coase's result as the "welfare economics analogue of Say's law." *Id.* Say's law is a proposition originating in the classical economics of the early 19th century that holds that "supply creates its own demand" and, as a result, there can never be a general overproduction (and thus, some would say, recession) in the economy. It was not until the work of John Maynard Keynes a century later that economists developed an effective theoretical counter to Say's argument. See JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* 18 (1936).

139. Calabresi, *Transaction Costs*, *supra* note 129, at 72.

140. *Id.*

141. Calabresi, *The Wonderful World of Blum and Kalven*, *supra* note 5, at 231–32 n.28.

142. Calabresi, *Changes for Automobile Claims?*, *supra* note 104, at 607.

143. *Id.*

144. *Id.* at 608.

145. Guido Calabresi, *Does the Fault System Optimally Control Primary Accident Costs?*, 33 *LAW & CONTEMP. PROBS.* 429, 447 (1968).

tion, Calabresi was stating, for the first time, the idea that later became known as the “normative Coase theorem,” which holds that one should structure the law to remove impediments to private agreements.<sup>146</sup>

Third, and perhaps of the greatest long-run significance for the economic analysis of law, Calabresi argued that the Coase theorem could serve as a guide to, and perhaps even justification for, real-world judicial decision making. As Calabresi pointed out in 1968, the effect of Coase theorem-type bargains is to minimize the cost of accidents. Thus, if this efficiency criterion is the goal for law, this implies that “[t]he resource allocation aim is to approximate, both closely and cheaply, the result the market would bring about if bargaining actually were costless.”<sup>147</sup> In making this claim, Calabresi brought the “mimic the market” criterion into legal thinking well before Richard Posner made it famous, and Calabresi used the Coase theorem to provide the theoretical justification for this approach.<sup>148</sup>

The Coase theorem, then, was a useful weapon in Calabresi’s crusade to replace the fault system with a market-based system of deterrence. The theorem showed how the market could efficiently accomplish such deterrence, and the real-world impediments to the accomplishment of the results contemplated by the Coase theorem provided a blueprint for factors that should be taken into account in devising a system to allocate costs in a world of imperfect markets.<sup>149</sup> “If we, as a society, are generally committed to a free market,” said Calabresi, “we should try to retain, expand, and make more efficient the market part of” the decision as to how to allocate the cost of accidents.<sup>150</sup> The Coase theorem did precisely this by showing that an ongoing market exchange relationship need not exist to accomplish deterrence, but that something approaching the results that would emerge from a deterrence relationship, were it feasible, could be implemented to accomplish cost-minimizing deterrence.<sup>151</sup> By the end of the 1960s, then, Calabresi was a committed believer in the theorem’s logic and utility, even if equally convinced of its limited direct real-world applicability.

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146. ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 92 (6th ed. 2012).

147. Calabresi, *Transaction Costs*, *supra* note 129, at 69.

148. On the use of the Coase theorem to justify the efficiency basis for legal decision making, see Steven G. Medema, *Legal Fiction: The Place of the Coase Theorem in Law and Economics*, 15 *ECON. & PHIL.* 209 (1999). It is noteworthy that Lawrence Tribe labeled this the “Coase–Calabresi” position. See Lawrence H. Tribe, *Policy Science: Analysis or Ideology?*, 2 *PHIL. & PUB. AFF.* 66, 90 (1972). One could argue that attributing this idea to Coase is a bit of a stretch, but the attribution to Calabresi suggests his centrality in this history, which later came to be more closely linked to Posner and Chicago. See Kitch, *supra* note 2, at 227.

149. Calabresi, *Changes for Automobile Claims?*, *supra* note 104, at 610.

150. *Id.*

151. *Id.* at 607.



## IV. PRODUCTS LIABILITY

Though the debate between Blum and Kalven and Calabresi and its attendant references to Coase's negotiation result extended into the late 1960s, the spread of Coase's result into areas of legal analysis beyond automobile accident law was already well underway—stimulated in part by this debate, which, because of the prominence of the outlets in which these articles appeared and the pertinence of the subject, had the effect of exposing a larger community of scholars to Coase's result. As we shall see, what particularly stands out in these discussions is that legal scholars took Coase's negotiation result seriously as an insight that potentially could inform legal analysis and that could be applied to a variety of legal questions. The most substantial set of applications was made within the realm of products liability law—a move that, as it happened, involved an interesting twist on Coase's analysis.

A. *Liability in Theory*

Calabresi's economic analysis of liability in the context of accident law spilled over rather quickly to the discussion of products liability, itself a topic of some controversy in the 1960s, and carried Coase's negotiation result along with it.<sup>152</sup> Given that accident law was the original entry point for the Coase theorem in the legal literature, it perhaps is understandable that this result would make its way into products liability analysis—particularly in light of the fact that Calabresi and Blum and Kalven had made reference to products-liability-related issues in their respective analyses of accident law. These discussions were picked up on in the subsequent products-liability literature and, perhaps not surprisingly, this literature reflects some of the same attitudes toward Coase's result that we find in Calabresi and in Blum and Kalven. What is particularly interesting, though, are the various ways in which this result was applied to aspects of products-liability analysis.

At the heart of the discussions of products liability during this period was the tendency of the courts to hold manufacturers strictly liable for the harm caused by their products—that is, to hold them liable regardless of whether they were demonstrably at fault for the harm or whether the consumer had undertaken appropriate precautions in the

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152. See, e.g., Marc A. Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective-Product Cases*, 18 STAN. L. REV. 974 (1966) [hereinafter Franklin, *When Worlds Collide*]; Marc A. Franklin, *Replacing the Negligence Lottery: Compensation and Selective Reimbursement*, 53 VA. L. REV. 774 (1967) [hereinafter Franklin, *Replacing the Negligence Lottery*]; Friedrich Kessler, *Products Liability*, 76 YALE L.J. 887 (1967); Joseph N. Onek, *The Montreal Agreement and Enterprise Liability*, 33 J. AIR L. & COM. 603 (1967); Paul C. Weiler, *Defamation, Enterprise Liability, and Freedom of Speech*, 17 U. TORONTO L.J. 278 (1967); W. Page Keeton, *Products Liability—Inadequacy of Information*, 48 TEX. L. REV. 398 (1969).

use of the product. One artifact of strict liability was a willingness of the courts to, in some instances, invalidate disclaimers that accompanied the sale of the product, wherein the consumer, by purchasing the product, agreed to absolve the manufacturer of liability for harms caused by product defects. Professor Marc Franklin of Stanford Law School took up Coase's negotiation result when discussing the disclaimer issue in, *When Worlds Collide: Liability Theories and Disclaimers in Product Cases*, which was published in the *Stanford Law Review* in 1966.<sup>153</sup> Franklin clerked for Chief Justice Earl Warren from 1958–1959, the same period during which Calabresi was clerking for Justice Hugo Black, and the two became good friends. One artifact of this relationship was that Franklin had followed the Calabresi–Blum and Kalven debate, and he recognized the relevance of this work, including Coase's negotiation result, to his own analysis.<sup>154</sup>

Franklin referenced the case of a New York woman who joined a fitness club and was subsequently injured in a fall near the club's swimming pool. As the result of the fall, she filed suit against the club.<sup>155</sup> The club's membership contract included a disclaimer that absolved the club from liability for injuries caused by the negligence of its employees, and the court found in the club's favor, arguing that there were no grounds for invalidating the contract whose terms had been freely agreed upon by the two parties.<sup>156</sup> Though the court upheld the disclaimer, Franklin pointed out that there was precedent in New York case law for disclaimer invalidation, one of the rationales for which was that the presence of a valid disclaimer would lead to increased carelessness on the part of businesses. Franklin's assessment was that this carelessness justification had, as he put it, "theoretical difficulties," and he grounded his position in Coase's negotiation result.<sup>157</sup> If courts do not uphold disclaimers, said Franklin, the businesses will adjust their prices upward to account for the increase in expected liability costs.<sup>158</sup> If the disclaimers *are* upheld, in contrast, consumers will see the costs of insurance increase.<sup>159</sup> But this, in turn, will lead consumers to demand that businesses lower their prices in order to help the consumers offset some of these increased costs.<sup>160</sup>

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153. Franklin, *When Worlds Collide*, *supra* note 152, at 1005. Franklin received his legal education at Cornell. *Marc A. Franklin, Frederick I. Richman Professor of Law, Emeritus. Biography*, STANFORD LAW SCH., <https://www.law.stanford.edu/profile/marc-a-franklin> (last visited Oct. 1, 2014).

154. Letter from Guido Calabresi to Steven Medema (Sept. 18, 2012) (on file with author); Letter from Marc Franklin to Steven Medema (July 20, 2012) (on file with author).

155. *Ciofalo v. Vic Tanney Gyms, Inc.*, 177 N.E.2d 925 (1961). *See also* Franklin, *When Worlds Collide*, *supra* note 152, at 1004.

156. *Ciofalo*, 177 N.E.2d at 926.

157. Franklin, *When Worlds Collide*, *supra* note 152, at 1005.

158. *Id.*

159. *Id.*

160. *Id.*

The effect is that the net prices/costs faced by businesses and consumers will not vary across the two different disclaimer regimes.<sup>161</sup> As such, said Franklin (citing Coase), the fear of increased carelessness is unjustified: the existence of valid disclaimers “should have the same incentive toward safety that the basic law of negligence would have in the absence of disclaimers.”<sup>162</sup>

The alert reader may have noticed that Franklin’s analysis bears a striking similarity to Blum and Kalven’s discussion of the watch-dial case and Calabresi’s workers’ compensation illustration, where the parties are involved in what Calabresi referred to as a (pre-existing) “bargaining relationship”—situations where, for more than a half-century, it was asserted that the assignment of liability would have no allocative impact.<sup>163</sup> It would seem, then, that Franklin was on solid theoretical ground in his assertions regarding invariance. Yet, Franklin was ascribing this result to Coase, whose analysis in *The Problem of Social Cost* had dealt neither with market-wide phenomena nor with parties who are in an existing bargaining relationship, but rather with situations of bilateral negotiations among independent agents.<sup>164</sup> It would appear, then, that things are beginning to get a bit murky.

Complicating the matter still further is the fact that Franklin was far from the only scholar during this period to expand the Coase theorem’s domain and ostensible originality in this way. This propensity to assimilate market-wide phenomena into Coase’s negotiation result continued in Paul Weiler’s evaluation of the application of strict liability to defamation cases, which was published in the *University of Toronto Law Journal* the following year.<sup>165</sup> This subject led Weiler, of the University of Toronto’s Osgoode Law School, to explore the larger treatments of liability in tort law, including the Calabresi–Blum and Kalven debates over the allocation of the cost of accidents, in the process of which he brought Coase into his discussion.<sup>166</sup>

Weiler considered Coase’s analysis an attack on the concept of enterprise liability and on the claim that enterprise liability was necessary to achieve a “rational”—that is, efficient—allocation of resources.<sup>167</sup> Coase’s argument, he said, informs us that, “[s]tarting from a situation in which the loss arises *out of a bargaining relationship between plaintiff and defendant*, it can be shown that the ultimate incidence of the loss will be determined by the structure of the mar-

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161. *Id.*

162. *Id.*

163. Calabresi, *The Decision for Accidents*, *supra* note 5, at 730.

164. *See generally* Coase, *Social Cost*, *supra* note 1.

165. Weiler, *supra* note 152. Weiler received his LL.B. from the University of Toronto’s Osgoode Hall Law School in 1964 and his LL.M. from Harvard Law School in 1965. Paul C. Weiler, *Henry J. Friendly Professor of Law, Emeritus*, HARVARD LAW SCH., <http://hls.harvard.edu/faculty/directory/10940/Weiler> (last visited Oct. 1, 2014).

166. Weiler, *supra* note 152.

167. *Id.* at 297.

ket, no matter where it is originally attributed by the law.”<sup>168</sup> Moreover, Weiler went on to note that, assuming “the conditions for a rational market” are satisfied, the resulting allocation of resources will be that which is most efficient, with all cost-effective safety measures being adopted.<sup>169</sup> In light of this, he concluded that, “given our original assumption about tort law (in the absence of fault)” —that the goal is to minimize accident losses through a combination of compensation and deterrence<sup>170</sup> —“the law should not waste its resources by shifting the loss from where it originally fell.”<sup>171</sup> In short, contradicting those who argued that a rational or efficient allocation of resources requires that the costs be placed on the agents who generate the costs, Coase’s logic, at least in Weiler’s hands, showed that there is simply no efficiency-based rationale for a move to enterprise liability. And once again, Coase’s bilateral bargaining analysis was interpreted as applying to, and providing the theoretical basis for understanding, market-wide phenomena involving losses or harms that occur within existing bargaining relationships—with no apparent recognition of the fact that this was a long-established result in economic theory.

One of the several oddities of Coase theorem-related legal scholarship during the 1960s, at least when viewed against the backdrop of the traditional stories of “law and economics” as a Chicago-driven movement, is that the theorem was invoked in scholarship emanating from Yale more often than it was in that from Chicago (about which more below). But curiously, Calabresi’s careful attempt to distinguish between the existing bargaining relationship and the situations contemplated by Coase was disappearing, even at Yale. Calabresi’s Yale colleague, the Legal Realist, Friedrich Kessler, like Franklin, invoked Coase’s negotiation result in the context of disclaimers—in this case, in the evaluation of whether disclaimers should be permitted if they are paid for via a two-tiered pricing structure.<sup>172</sup> Under such a system, the product in question could be sold without a disclaimer at one price and with a disclaimer at another, lower price.<sup>173</sup> This system, Kessler pointed out, was implicit in existing practices of charging different prices for warranties of different lengths and for products, such as automobiles, with different optional safety features.<sup>174</sup> Should the same pricing practice, he asked, be allowed in the presence or absence of a disclaimer?<sup>175</sup> In theory at least, Coase’s analysis suggests that it should, and the economic logic here is virtually identical to that in Franklin’s discussion. The higher product price that accompanied the

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168. *Id.* at 297–98 (emphasis added).

169. *Id.* at 298.

170. *Id.*

171. *Id.*

172. Kessler, *supra* note 152, at 925.

173. *Id.* at 933.

174. *Id.*

175. *Id.*

absence of a disclaimer effectively amounts to the consumer's purchase of insurance against product defects, and the theory would predict the emergence of a set of market prices that precisely accounts for the allocation risk in the presence or absence of the disclaimer—with no differential effects on prices, output levels, or accidents. Once again, then, Coase's analysis was put forward as a justification for the idea that existing markets could effectively and invariantly internalize costs.

This theme was continued in Joseph Onek's analysis of liability for aviation accidents.<sup>176</sup> Onek, a former student of Calabresi at Yale<sup>177</sup> then occupying a federal court of appeals clerkship, argued that, while deterrence requires putting accident costs on those participating in the relevant activity, it does not tell us on which party the costs should be placed in order to achieve the appropriate level of deterrence. Onek's first stab at answering the liability question involved an appeal to Coase, the single cited source for his claim that "economists have pointed out that, in theory, it does not matter whether the costs of aviation accidents are initially borne by the airlines or the passengers."<sup>178</sup> The absorption of the existing bargaining relationship context into Coase's negotiation result is evident in Onek's assertion that this result derives from the fact that "airlines and passengers stand in a bargaining relationship to each other" through the purchase and sale of tickets.<sup>179</sup> His explanation of the logic of invariance here parallels that in Franklin's discussion of the gymnasium disclaimer case: "If the accident costs are placed on the airline," he said, "it will charge more for flights in order to purchase liability insurance or self-insure."<sup>180</sup> "If costs are placed on the passengers, they will wish to take out insurance and, in theory, at least, will demand that airline prices be lowered accordingly."<sup>181</sup> The result, he said, is that "[e]ither way the same market pressure for greater safety will ultimately reach the airline."<sup>182</sup>

The Yale connection continued in 1967 with a student note, authored by Henry L. Woodward, on *Borrowed Servants and the Theory of Enterprise Liability*, which was published in the *Yale Law Journal*.<sup>183</sup> Here, Woodward invoked Coase's negotiation result in the context of an analysis of whether negligent employees, rather than

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176. Onek, *supra* note 152, at 605.

177. Yale University Library Manuscripts and Archives, Living Graduates and Non-Graduates of Yale University Sixty-fourth Series Number 11 at 878 (June 1, 1968) (unpublished manuscript) (on file with Yale University Library System).

178. Onek, *supra* note 152, at 605.

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. Note, *Borrowed Servants and the Theory of Enterprise Liability*, 76 *YALE L.J.* 807 (1967). Although an unsigned note, Calabresi confirmed the author as Henry L. Woodward. E-mail from Guido Calabresi to Steven Medema (Aug. 31, 2012) (on file with author).

employers, should be held liable for damage caused by accidents associated with the use of a company's product.<sup>184</sup> Woodward noted that strict manufacturer liability, which was often recommended because the employer can better spread the costs of accidents (over consumers generally, through higher prices) and that manufacturer liability will better promote general deterrence, was being challenged.<sup>185</sup> Specifically, “[c]ommentators have argued that, from the standpoint of resource allocation, accident costs could as well be placed on employees as on their employers.”<sup>186</sup> The logic here, of course, is identical to the workers' compensation situation that economists had examined, reaching the same conclusion, in the early 1900s. Woodward applied the same line of reasoning to relationships between independent contractors, such as a crane company and a building contractor, noting that “the initial allocation of loss” for crane accidents “is immaterial” because prices will adjust to allocate costs identically regardless of whether the crane company or the building contractor is made liable at law.<sup>187</sup>

While Woodward's initial supporting reference for the allocative invariance idea was Calabresi's *The Decision for Accidents*, Woodward pointed out that “[t]he idea that *actual or potential* bargaining parties will always reach the same final allocation of costs regardless of the initial placement of liability has been given its most cogent theoretical elaboration” by Coase in *The Problem of Social Cost*.<sup>188</sup> Woodward too, then, was explicitly linking Coase to the analysis of parties in an existing bargaining relationship, and this in spite of Calabresi's careful differentiation between these two insights in his 1965 article.<sup>189</sup> But again, the context and logic was not that of Coase's bilateral bargaining framework; instead, it was the much older one of market prices adjusting in response to different assignments of liability.

Three themes emerge from these several discussions of products liability law. First, and most obviously, Coase's negotiation result was slowly being grafted into the analysis of products liability. Second, and quite interestingly, though some mention was made of efficiency, it was not the primary focus of these discussions of Coase's result; rather, the focus was largely on invariance—the idea that the allocation of costs, the deterrent effect, etc. would not be impacted by the location of liability placement. This represents both an interesting take on Coase, and a significant departure from Calabresi and from the economists discussing Coase's result during the 1960s, the latter of whom, like Calabresi, were much more focused on the idea that costs

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184. Woodward, *supra* note 183, at 815.

185. *Id.*

186. *Id.*

187. *Id.* at 816.

188. *Id.* at 815 n.33 (emphasis added).

189. *Id.* at 815.

would be allocated *efficiently* through the negotiation process than on the idea that allocation would be invariant across alternative assignments of liability.<sup>190</sup> Third, the distinction made by Calabresi and by Blum and Kalven between the presence and absence of a (pre-existing) bargaining relationship had all but disappeared, and Coase was seen as having provided the theoretical argument that underlies the former as well as the latter.

Why does this last distinction matter? Part of this goes to the nature and originality of Coase's result. As we have already noted, and as Calabresi emphasized, Coase did not discuss the existing relationships and the market-wide phenomena associated with consumer products, workers' compensation, and the like. Yet, his authority as an economist was being invoked to support invariance claims in these situations, and his negotiation result was viewed as having demonstrated as much, when in fact it had not. Furthermore, and as we have already noted, the invariant effects of alternative assignments of liability in a market context was well-established decades before Coase penned *The Problem of Social Cost*, meaning that even if one wished to ascribe this result to Coase, it was not original with him. What was effectively playing out here, then, was *an expansion of both the range and domain of Coase's negotiation result at the hands of legal scholars*.

There is more to all of this, though, than questions of priority, correct attribution, and what Coase had or had not said and demonstrated; there is also an important theoretical issue in play. The "existing relationships" result reflects the basic economic intuition that markets can be expected to do a reasonable job of translating costs into prices. But markets tend to function more smoothly than do individual bargaining situations because "individuals" do not matter—the agents have an established forum for cost- and price-related interactions, and in reasonably competitive situations, no one actor has any significant control over price. In such situations, economic theory had for some two centuries suggested that market prices will adjust to take account of cost- and benefit-related phenomena, whether these take the form of different assignments of liability for workers' compensation, different product or occupational attributes (including risk), or advantages or disadvantages of location. The situations contemplated by Coase embodied none of the market-related characteristics that generate the smooth price adjustments of this traditional theory. They simply involved parties with no regularized form of market interaction whose respective activities put them into conflict with each other. The framework and logic through which their disputes are resolved, via the negotiation mechanisms contemplated by Coase, are completely different from those for parties in an existing market relationship. But regardless of one's perspective on these theoretical niceties, the fact

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190. See Medema, *Rethinking Market Failure*, *supra* note 4, at 59.

remains that the nature of Coase's negotiation result was being *re-shaped*—one of many illustrations that the “Coase theorem” was something that evolved and was worked out in the literature of this and succeeding periods by the various communities of scholars who brought it into their discourse.

### B. *Liability in Practice*

Each of the authors discussed above believed that Coase's negotiation result provided the underpinnings for an assertion that, in theory, the direction of products liability would not influence behavior or outcomes in this realm. When it came to actual implementation and thus the practical utility of Coase's insight, however, a very different view emerged. The issue, as each of these authors emphasized, is that Coase's negotiation analysis turns out to be unrealistic for several reasons.

Franklin offered three criticisms of the negotiation result, each of which went to problems that would manifest themselves if consumers were made liable and thus not only went against the invariance claim but spoke in favor of enterprise liability.<sup>191</sup> First, he said, consumers often are not in as good a position to assess the risk of injury as are the business owners, and the consumer is unlikely to be able to properly self-insure against injury.<sup>192</sup> Second, insurance purchased by consumers against injuries caused by defective products is unlikely to cover non-monetary (e.g., pain and suffering) losses.<sup>193</sup> Third, consumers are unlikely to have sufficient bargaining power to induce the businesses to reduce their prices to account for the risk being borne by the consumers.<sup>194</sup>

To this Kessler added two more factors that he believed would make the Coasean solution problematic: first, the number of parties potentially involved, and second, the fact that a seller cannot predict who may be harmed by a defective product.<sup>195</sup> In the latter case, though the buyer may have willingly assumed the relevant risks, someone other than the person to whom the seller originally sold the product may be harmed. For example, a passenger in an automobile or a pedestrian may be harmed as the result of an automobile defect manifesting itself, but these individuals were not party to the transaction over the automobile.<sup>196</sup> These factors, said Kessler, tell us that “[t]he sale of dangerous products does not fall into the bargaining pattern envisioned in Mr. Coase's analysis.”<sup>197</sup> Both Weiler and Woodward

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191. Franklin, *When Worlds Collide*, *supra* note 152, at 1005.

192. *Id.*

193. *Id.* at 1005–06.

194. *Id.* at 1006.

195. Kessler, *supra* note 152, at 933.

196. *Id.*

197. *Id.*



echoed these same cautionary themes, but Weiler went a step further, arguing that, as Calabresi had emphasized, in the absence of a pre-existing bargaining relationship, there is the further problem that the “cost[s] of achieving a viable market” may greatly exceed the associated benefits.<sup>198</sup>

The thrust of these arguments, then, was that the presence of what we now call “transaction costs” would preclude the operation of the Coasean negotiation process in the real world. This pessimism about the ability of the Coasean outcome to manifest itself in products liability cases—particularly as relates to the consumer side of the relationship—led these authors to support the imposition of liability on sellers, on grounds ranging from deterrence to cost effectiveness.<sup>199</sup> Franklin nicely captured the overall tenor of this discussion—that Coase’s result is a nice argument in theory but lacks significant real-world applicability—when he summarized his own analysis of disclaimers with the assertion, “if the parties are really in a position to bargain over the cost consequences of any increased negligence, there is no reason to fear that there will be increased carelessness as the results of disclaimers,” but if such bargaining is not possible, as will often be the case in reality, “a seller who has superior bargaining power over all contract prices and terms” will have “the buyer at his mercy,” leading to an unfair outcome in the absence of regulation.<sup>200</sup> In short, the unanimous view was that there are significant hazards associated with legal rulemaking based upon a presumption in favor of Coase’s result.

While Franklin et al. appear to have been willing to accept the implications of Coase’s negotiation result for legal decision making were the relevant bargaining processes feasible, not everyone was on board

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198. Weiler, *supra* note 152, at 298 n.103 (citing Calabresi, *The Wonderful World of Blum and Kalven*, *supra* note 5, at 224–33). Franklin also cited Coase to the effect that it may be costly to establish an equal bargaining position. See Franklin, *When Worlds Collide*, *supra* note 152, at 1006 n.189; Coase, *supra* note 1, at 15–19. Milton Katz made a similar argument in an article on tort liability and technology assessment:

At this point, however, I want only to remark again that the incidence of a cost is determined by the legal order. Damage to the community caused by waste products from our hypothetical electric power plant will be a ‘social’ and ‘external’ cost only if and to the extent that the legal system may so decree. The legal system may alter or maintain the incidence of a cost by recognizing, or declining to recognize, a cause of action in tort against the company. It may enable the persons involved to adjust or modify the incidence of a cost, or frustrate their efforts to do so, by giving effect, or refusing to give effect, to agreements among them.

Milton Katz, *The Function of Tort Liability in Technology Assessment*, 38 U. CIN. L. REV. 587, 593 (1969).

199. See, e.g., Franklin, *When Worlds Collide*, *supra* note 152, at 1007–12; Onek, *supra* note 152, at 605; Woodward, *supra* note 183, at 815; Franklin, *Replacing the Negligence Lottery*, *supra* note 152, at 783–84.

200. Franklin, *When Worlds Collide*, *supra* note 152, at 1006.

with this viewpoint. University of Texas Law School Dean W. Page Keeton, for one, pointed to the unusual nature of the argument made by “[s]ome economists” that, on efficiency grounds, it may be best to assign liability for injuries caused by defective products to someone other than the manufacturers of those products and the attendant notion—more important for present purposes—that, even if courts are inclined to hold manufacturers liable, the manufacturers and consumers should be allowed to engage in voluntary bargains that would absolve the former of liability.<sup>201</sup> The message associated with this position, Keeton said, was that courts should honor disclaimers—a message that he opposed. Equally concerning to Keeton was the more philosophical point that the rationale provided for this position, which he attributed to Coase and to Calabresi in his 1968 defense of the Coase theorem,<sup>202</sup> was nothing more than efficiency—that “voluntary exchange will result in both less expensive products and the allocation of ultimate responsibility for avoiding accidents to the one who has the comparative advantage economically to avoid the cost of the accidents.”<sup>203</sup>

Keeton found the implications of the economists’ stance sufficiently at odds with received legal thinking that he felt compelled to italicize his entire explication of them:

*This would mean that a consumer and others who are injured through the use of a product do not have any right to be secure from harm from dangerous products apart from a right to be informed or apart from safety legislation. Moreover, safety legislation that would require the elimination of an open and obvious type of danger and that interferes with voluntary market arrangements would necessarily be suspect.*<sup>204</sup>

Keeton, was not concerned with the particulars of whether Coase’s result was likely to be applicable to the real world. Rather, like Blum and Kalven, he simply could not countenance setting aside what he saw as the established legal framework in favor of the economic approach and the evaluation of outcomes grounded in the primacy of the market.<sup>205</sup> Even if one granted the economists’ position on efficiency, he said, “fairness in the allocation of the cost of accidents when they do occur should be the primary concern of the law.”<sup>206</sup> Where economists were concerned with the minimization of costs, Keeton emphasized that “[e]very effort should be made to minimize” not the cost of accidents, but the impact of accident costs on “wealth distribution.”<sup>207</sup>

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201. Keeton, *supra* note 152, at 401.

202. *See id.*

203. *Id.* at 401.

204. *Id.*

205. *Id.* at 401–02.

206. *Id.* at 401.

207. *Id.*

In short, he considered the theory of efficient deterrence to be “of dubious significance” compared to questions of fairness and justice in these cases.<sup>208</sup> For Keeton, then, the Coase theorem, and the economic approach to law generally, missed the mark not because of any lack of realism, but because of a conflict with what he believed to be the ethical foundations of the law.<sup>209</sup>

It is fair to say that Coase’s negotiation result played little more than a bit part in the larger discussion of tort law in the 1960s, though *The Problem of Social Cost* was referenced in roughly 25% of the articles citing Calabresi’s influential work on the subject during this period. The citation patterns in the literature discussed in this Section suggest that it was *through* Calabresi, Blum, and Kalven that Coase’s insight made its way into the products liability literature, as opposed to Coase’s analysis having been brought into the discussion because these scholars had read Coase and felt that his negotiation result merited some attention in their analysis. The treatments accorded to the Coase theorem parallel both the discussion that we witness in the Calabresi–Blum and Kalven debate and the treatments by economists who discussed Coase’s result in the context of externality analysis, in that Coase’s result, when it was mentioned, was accepted as a *theoretically* valid proposition, but the extent of its applicability was thought to be very limited.

## V. BEYOND THE LAW OF TORTS

While torts was the area of law in which Coase’s negotiation result was most often discussed during the 1960s, scholars working in other areas were also drawing on this idea. Of the various legal treatments of Coase’s negotiation result during this period, that by his University of Chicago Law School colleague Allison Dunham in his article, *Promises Respecting the Use of Land*,<sup>210</sup> was undoubtedly the closest in form and spirit to Coase’s own discussion. The legal context of Dunham’s article, which was published in the *Journal of Law and Economics*—by then under Coase’s editorship—in 1965, was land-use conflicts of the type contemplated by Coase, and though Dunham made direct reference to Coase—and also to George Stigler’s 1966 elaboration of a “Coase theorem”—only in an early footnote to literature treating externality-related nuisance, the analysis, examples, and

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208. *Id.*

209. *See id.* at 402. (Keeton’s objections, of course, went to the heart of the criticisms that were to be leveled against the economic analysis of law in the 1970s and 1980s). *See, e.g., Symposium on Efficiency as a Legal Concern*, HOFSTRA L. REV. (1980); *A Response to the Efficiency Symposium*, HOFSTRA L. REV. (1980). That said, Keeton was not willing to declare that economics had nothing to offer to law. *See* Keeton, *supra* note 152, at 402.

210. Allison Dunham, *Promises Respecting the Use of Land*, 8 J.L. & ECON. 133 (1965) [hereinafter Dunham, *Promises*].

even the language of Dunham's article show the unmistakable influence of *The Problem of Social Cost* on his thinking.<sup>211</sup>

But Dunham did not come to this position naturally. He had arrived at Chicago along with Karl Llewellyn in the early 1950s and, like Llewellyn, was less than enamored of the economics in the air at the law school.<sup>212</sup> It was not long, however, before Dunham's attitude began to change, and Henry Manne has related the story of Dunham's conversion experience:

There was the tea every afternoon down in the student lounge, and we noticed that early on in that year—this was fifty-one or fifty-two—that [sic] someone of Walter Blum, Harry Kalven, [Bernard] Meltzer, sometimes [Edward] Levi, often Aaron [Director], would talk with Allison Dunham in that room. Early in the fall, as he began to hear what was being said about economics and economics and law at Chicago, he just was completely incredulous. He just could not believe it. He had a kind of sneering response to this that it couldn't really be. The process continued. Every afternoon one could watch it as Dunham began to weaken, or smarten, I should say. By midyear he was listening attentively. He was no longer being hostile and opposing, and by the end of the year it was just one happy party as they were all investigating issues of interest all together. It was a quite remarkable thing to watch. In that one year someone who came from—literally—total ignorance even of the existence of the possibility of that kind of analysis to a rather confirmed and I would almost say sophisticated student of that time of law and economics.<sup>213</sup>

By the late 1950s, Dunham's scholarship was showing the impact that economics had on his thinking.<sup>214</sup>

Though writing only a year after Blum and Kalven had referred to Coase's analysis as an instance of "recent economic theorizing,"<sup>215</sup> Dunham characterized Coase's negotiation result as "conventional economic theory"—an interesting claim given that the economics profession as a whole was by no means on board with Coase's analysis at this point. The negotiation result, if "conventional theory," was only so at the Universities of Chicago and Virginia—and perhaps UCLA.<sup>216</sup> Dunham also considered the negotiation result to be some-

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211. See *id.*; Coase, *Social Cost*, *supra* note 1.

212. See Kitch, *supra* note 2, at 186–87.

213. *Id.* at 187.

214. See, e.g., Allison Dunham, *City Planning: An Analysis of the Content of the Master Plan*, 1 J.L. & ECON. 170 (1958).

215. Blum & Kalven, *Public Law Perspectives on a Private Law Problem*, *supra* note 5, at 699. See also discussion *supra* p. 170–71.

216. Dunham, *supra* note 210, at 135. Dunham's "conventional" label resonates with the characterization of the theorem given by University of Chicago economist George Stigler in his 1966 price theory textbook. See STIGLER, *supra* note 3, at 110–14. See also Medema, *supra* note 4 (describing the treatment of Coase's result by economists in the early 1960s).

thing more than a theoretical curiosity, pointing to *Lewis v. Gollner*<sup>217</sup> as an example of a case in which “bargaining was used to rearrange the uses which affect each other.”<sup>218</sup> The particulars of this case are as follows.

Gollner purchased a parcel of land in a nice residential neighborhood with the goal of constructing tenement houses and flats.<sup>219</sup> The residents of the neighborhood objected to this, and a deal was struck wherein Gollner agreed to sell the parcel for a net profit of \$6,000 and a promise that he would not construct any such flats in the neighborhood.<sup>220</sup> Negotiated solutions such as this one, said Dunham—and he cited several others from case law—have the effect of “maximiz[ing] satisfactions by arranging the uses so that the least diseconomies would result.”<sup>221</sup> This situation, then, illustrated for Dunham that Coase’s negotiation result was a valid and realistic proposition.<sup>222</sup> And if that were the end of the story, all would be well. But, as it happens, it was not. Immediately after concluding negotiations with Lewis, Gollner purchased a lot across the street from that which he originally owned and began to erect a seven-story flat.<sup>223</sup> Lewis then announced his intention to file suit, at which point Gollner transferred the ownership of the property to the name of his wife, presumably with the idea that this would insulate him from liability for breach of promise.<sup>224</sup>

What we have here, then, is a case where a welfare-improving bargain was made, in the spirit of Coase, but one party later tried to get around the result of the bargain.<sup>225</sup> This, for Dunham, raised the problem of how to ensure the keeping of promises with respect to the use of land—the larger subject of his article. While Coase’s negotiation analysis was useful on its own terms, *Lewis v. Gollner*, Dunham said, was illustrative of the need for legal instruments to police and enforce the bargains once made so that the efficiency-enhancing outcomes contemplated by Coase’s analysis are actually achieved.<sup>226</sup> For Coase’s negotiation solution to work its efficiency-enhancing magic in situations such as that found in *Lewis v. Gollner*, there must be legal mechanisms in place to ensure that promises respecting land use are,

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217. *Lewis v. Gollner*, 29 N.E. 81 (N.Y. 1892).

218. Dunham, *Promises*, *supra* note 210, at 135.

219. *Lewis*, 29 N.E. at 81.

220. *Id.*

221. Dunham, *Promises*, *supra* note 210, at 137–38.

222. *Id.*

223. *Id.* at 137.

224. *Id.*

225. *Id.* at 135–37.

226. The issues raised by Dunham here are not dissimilar to those pointed to by his University of Chicago colleague, Harold Demsetz of the Graduate School of Business, in a 1964 article published in the *Journal of Law and Economics*. See Demsetz, *supra* note 135. If Dunham was aware of Demsetz’s work, it is not indicated in his article.

in fact, adhered to, and Dunham spent the remainder of the article fleshing out how law might facilitate this in an exposition that provided the basis for literature worked out in the 1970s suggesting that private bargaining and the law of covenants provided an efficient market alternative to zoning.<sup>227</sup>

Dunham, then, was clearly of the mind that efficiency-enhancing bargains *à la* Coase had significant potential for realization if the law created the appropriate context for such bargains. Indeed, he was far more optimistic about this prospect than were many other legal commentators during this period. One of the more intriguing aspects of Dunham's discussion is the fact that he did not cite Coase, or anyone else, directly in making his arguments about the negotiation result—chalking it up instead to “conventional economic thinking,” as we noted earlier. This may speak to the general acceptance of this stream of thought at Chicago, at least among those disposed to be sympathetic to the application of economic thinking to the law. It is also worth noting, by way of contrast with the products-liability literature, that Dunham made no mention of Coase's invariance claim, electing instead to devote his focus to the question of efficiency.

Coase's negotiation result was also brought in by lawyers in discussions of a wide range of regulatory issues, and several of them, like Dunham, saw promise in the alternative that Coase's analysis offered to traditional political-regulatory solutions. The earliest example of this line of scholarship was Yale Law School professor Ward Bowman's treatment of the social costs and benefits related to continued passenger (commuter) service on the New Haven Railroad, published in the *Journal of Law and Economics* in 1966.<sup>228</sup> Bowman, who had been recruited to Yale from the University of Chicago and was a significant force in the development of the economics-infused Chicago approach to antitrust, was concerned with the question of whether the benefits of this railroad to the larger community justified the associated cost.

In an illuminating commentary that showed how economic theory could be utilized to find an essential unity in the analysis of very disparate phenomena—a feature that was to emerge front-and-center as the economic analysis of law continued to develop—Bowman argued that the analysis of the New Haven Railroad is no different from other

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227. See, e.g., Robert C. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681 (1973). The Author is grateful to Herbert Hovenkamp for bringing this point to my attention.

228. Ward Bowman, *The New Haven, a Passenger Railroad for Nonriders*, 9 J.L. & ECON. 49 (1966). One could reasonably dispute whether Bowman belongs in the present analysis, given that he was an economist, rather than a lawyer, by training. We have chosen to include him here because he spent virtually his entire academic career as a member of law school faculties—first at Chicago and then at Yale. See *The Modern Era, 1955-Present*, YALE LAW SCH., <http://www.law.yale.edu/cbl/moderenera.htm> (last visited Oct. 1, 2014).

situations that involve benefits or costs that spill over onto the larger community, such as “a lighthouse, a smoking factory, or a hotel.”<sup>229</sup> When it came to mechanisms for addressing these questions, Bowman opened by noting that:

A most useful analysis of this kind of problem has been presented in a previous issue of this Journal. Professor Coase showed that the resolution of the problem of social cost by private negotiation has much to recommend it over public coercion—such as banning a nuisance or, one might assume, subsidizing a benefit. The appropriateness of private negotiation is suggested because it leads to the “right” amounts of output. This result (appropriate resource allocation) is most likely when the beneficiaries or sufferers from the private conduct are few and identifiable and where the cost of carrying out the necessary negotiating process is not excessive.<sup>230</sup>

Though Coase’s analysis in *The Problem of Social Cost* assessed situations involving harm rather than benefit, Bowman emphasized that the analysis is equally useful for assessing the latter, and he provided a full exposition of the underlying logic—which, in summary form, argues that if people are willing to pay the cost associated with achieving the desired benefits, then the project that provides these benefits is both efficient and will be realized. This process, which Bowman called “a dollar bidding market solution” to the social benefits problem, allows for the identification of benefits through the marketplace and thus “calls for no political interference for a resolution of the problem of social benefit.”<sup>231</sup>

Like our torts commentators, Bowman was well aware of the practical problems involved in applying Coase’s analysis to the railroad question. In particular, the large numbers of parties involved and the dispersion of benefits raised potential problems for market solution. That said, Bowman was not optimistic about a political solution either, as he did not consider the voting system a good proxy for benefit quantification. But unlike the torts theorists, when it came to the choice between these imperfect alternatives, Bowman came down on the side of the market. “There is substantial reason,” he said, “for expecting that the market is likely to reach a better conclusion than is a vote for the railroad, a textile mill or a drug store,” particularly when one realizes that the voting process itself is not costless. That is, “private benefit,” for Bowman, “is a better proxy for social benefit than is a majority vote.”<sup>232</sup> The Coase theorem, in Bowman’s hands, thus pointed the way toward an expanded use of market, rather than regulatory, solutions for dealing with spillover problems.

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229. Bowman, *supra* note 228, at 50.

230. *Id.* at 51.

231. *Id.*

232. *Id.* at 58.

Here, too, Coase's result was finding its way into the writings of law-school students. Sentiments very similar to Bowman's can be found in a discussion of landlord-tenant relationships undertaken by E.A. Christensen, a second-year law student at Chicago, who cited Coase's negotiation result as the basis for a solution to the problem of housing quality for low-income tenants.<sup>233</sup> For Christensen, Coase's analysis suggested that in instances where landlords in slum-housing developments fail to properly maintain their buildings, landlords and tenants may be able to "obtain a satisfactory solution through bargaining," and that such a solution would provide an alternative, and perhaps a superior one, to existing proposals for leveling charges on landlords for failing to maintain their buildings at an acceptable standard.<sup>234</sup> Stanford Law School student Ozro Childs, meanwhile, argued that Coase's negotiation result had relevance for larger-scale legal-regulatory issues as well—such as the question of whether CATV companies could charge the broadcasters for transmitting their programs to a wider audience or whether the broadcasters would be allowed to charge the CATV companies for rebroadcasting their programming.<sup>235</sup> Childs argued that this decision as to who would be allowed to charge whom would have "no salutary effect on local broadcasting." Its only effect, he said, would be on the distribution of wealth between the affected parties—the CATV and broadcast companies.<sup>236</sup> Citing Coase in support of this claim, Childs noted that "[i]t is a well-accepted proposition that, unless bargaining is prohibited or made quite expensive, the allocation of resources in a competitive economy is not determined by the initial definitions of rights."<sup>237</sup> For Childs, the broadcasting industry clearly satisfied these conditions.<sup>238</sup>

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233. See E.A. Christensen, *The Public Housing Leasing Program: A Workable Rent Subsidy*, 1968 URB. L. ANN. 57 (1968).

234. *Id.* at 58 n.7 (arguing that the duties levied on landlords under the charges system may serve only to increase rents without providing for improvement of the premises and therefore do more harm than good since the fines reduce the amount of money available for improvements to the property, and that the bargaining solution, in contrast, would lead to negotiated improvements in living conditions in return for the higher rents paid by the tenants).

235. See Ozro W. Childs, IV, *The FCC's Proposed CATV Regulations*, 21 STAN. L. REV. 1685 (1969).

236. *Id.* at 1710.

237. *Id.* at 1710 n.87 (emphasis added).

238. *Id.* It is worth emphasizing that Childs believed that Coase's result would obtain so long as bargaining is not "quite expensive," suggesting broad latitude for Coasean bargains generally and the invariance proposition in particular, and also that he considered Coase's result "well accepted"—though he did not provide any evidence (citations or otherwise) to support the latter claim. University of North Carolina economist Douglas Webbink presented a similar argument in an article published in *Law and Contemporary Problems* at this same time. See Douglas W. Webbink, *The Impact of UHF Promotion: The All-Channel Television Receiver Law*, 34 LAW & CONTEMP. PROBS. 535 (1969). Webbink, who received his Ph.D. in economics from Duke, also invoked Coase, and noted that regardless of the direction payments are required to flow, both CATV companies and broadcast stations would benefit and consumers



But not all of those sympathetic to the Coase theorem or to the economic approach to law generally, even at Chicago, were enthusiastic about the possibilities of Coase-type market solutions as compared with regulatory ones. A case in point is Edmund Kitch, who had received his J.D. from Chicago in 1964 and was a member of the faculty there.<sup>239</sup> Kitch published an article in the *Journal of Law and Economics* in 1968 that examined the regulation of the natural-gas industry and, along the way, took note of the problems caused when natural-gas wells connected to pipelines drained gas from neighboring wells during the extraction process.<sup>240</sup> The owners of the neighboring wells were faced with a choice between having their gas drained away, and thus losing the associated revenue, and extracting and selling their gas immediately.<sup>241</sup> The incentive, of course, was to go the latter route, which resulted in an inefficient over-production of natural gas.<sup>242</sup> On the face of it, this might seem like a fruitful context for Coase's negotiation scheme to work its magic, given the commonalities with some of Coase's illustrations. But Kitch did not see things that way, and instead argued that "[t]his problem could *only* be solved by regulation which controlled production."<sup>243</sup> Why? It was not that Kitch was unaware of the potential applicability of Coase's insight here—indeed, far from it. Citing Coase, Kitch pointed out that "[t]he problem could also have been solved by negotiations among all producers in the field."<sup>244</sup> But, he said, "fields were large, producers numerous, and the common interest of all the producers poorly understood."<sup>245</sup> In short, practical considerations—transaction costs—precluded negotiated solutions and, for Kitch, necessitated government regulation.

It would appear that, Kitch's arguments notwithstanding, those discussing Coase's negotiation result outside of the torts context, taken as a group, expressed a more optimistic view of the possibilities of Coasean bargaining than did the torts theorists. The fact that such a large share of the articles mentioning Coase's result in the context of market regulation emanated from Chicago may explain some of this optimism, given the tendency of those working on regulatory issues at Chicago, both inside and outside of the walls of the law school, to see the imperfections associated with regulatory activity as more severe

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will be largely unaffected—other than that viewers would have more program choices with the advent of CATV. *See id.* at 535, 555 (1969).

239. Edmund W. Kitch, UNIV. OF VA. SCH. OF LAW, <http://www.law.virginia.edu/lawweb/faculty.nsf/FHPbI/1180712> (last visited Oct. 1, 2014).

240. Edmund W. Kitch, *Regulation of the Field Market for Natural Gas by the Federal Power Commission*, 11 J.L. & ECON. 243 (1968).

241. *Id.* at 253.

242. *Id.*

243. *Id.* at 253 (emphasis added).

244. *Id.* at 253 n.39.

245. *Id.*

than those associated with the market. The fact that the Chicago contributions, save for the work by Blum and Kalven, were predominately in the area of regulation may appear a bit unusual, given the breadth that we today identify with the “Chicago” law and economics. But we must bear in mind that law and economics at Chicago during this period was still very much focused on the antitrust and regulatory issues that reflected the interests of Aaron Director, whose efforts shaped the first generation of law and economics at Chicago, and those who surrounded him. The idea of applying economics, and the Coase theorem in particular, to the far corners of the law had not yet caught on, even at Chicago.

#### VI. THE COASE THEOREM AS A TOOL FOR LEGAL EXPLANATION

The uses of Coase’s negotiation result probed thus far were focused on how this result could inform an assessment of the impacts of alternative legal rules or on how the market-like solutions that this result suggests may offer a superior alternative to traditional regulatory schemes. Perhaps the most unique application of Coase’s result during the 1960s, however, comes not from considering its prescriptive power, but from its use to justify or explain the existence or utility of particular legal phenomena. The first instance of this sort of application of Coase’s result came from Dunham, who in *Promises Respecting the Use of Land*, considered possible rationales for the historical failure of judges to provide more than a very limited scope to the law of nuisance, in spite of the fairly wide range of situations in which the actions of one party impose costs on others. One of the rationales offered by Dunham went directly to Coase’s negotiation result, and his explanation instanced *Sturges v. Bridgman*,<sup>246</sup> one of the legal cases taken up by Coase to illustrate his result. The issue in *Sturges v. Bridgman* revolved around the noise and vibration emanating from the mortar and pestle used by a confectionary, which interfered with a neighboring physician’s ability to practice medicine.<sup>247</sup> In spite of the interference that the confectionary’s activity caused to the physician’s practice, the judge did not declare the offending activity a nuisance.<sup>248</sup> One possible explanation for this “judicial reluctance to develop the law of nuisance,” Dunham argued, was

judicial recognition of the economic fact that the appropriate mixture of doctoring and confectioning could be obtained by society without any law of nuisance. Bargains between neighboring property owners could take place which, according to conventional eco-

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246. *Sturges v. Bridgman*, (1879) 11 Ch. D. 852, (1883), 32 Reports of Cases Decided by the English Courts 837.

247. *Id.* at 853.

248. *Id.* at 862–63.

conomic theory, would, on the whole, allocate resources to candy-making and doctoring most economically.<sup>249</sup>

That is, Dunham was suggesting that judges may, in effect, have anticipated the insights underlying the Coase theorem.<sup>250</sup> Dunham offered no evidence to support this conjecture, but he obviously considered it likely that agents involved in conflicting use disputes would bargain “in the shadow of the law” if placed in an environment that encouraged such behavior and, moreover, that judges would have expected them to do precisely this.<sup>251</sup>

Coase’s negotiation result was also employed to provide a justification of governmental takings of private property, an application that is attended by no small amount of irony, given the anti-regulatory bias that is often attached to the Coase theorem. In fact, this argument was made *twice* in the late 1960s—first by Harvard Law School professor Frank Michelman in his now classic article, *Property, Utility, and Fairness: Comments on the Ethical Foundations of “Just Compensation” Law*, published in the Harvard Law Review in 1967,<sup>252</sup> and again two years later in Stanford Law School professor Douglas Ayer’s article, *Allocating the Costs of Determining “Just Compensation”*, published in the Stanford Law Review.<sup>253</sup> Interestingly, while both Michelman and Ayer utilized Coase’s negotiation result in their analysis, their emphasis was on the juxtaposition of this result with Coase’s discussion of the *problems* with negotiated solutions.<sup>254</sup>

As Michelman pointed out, Coase’s negotiation result has interesting implications for the analysis of regulatory takings. If the government attempts to justify a regulation as efficiency-enhancing, said Michelman,<sup>255</sup> this implies that *B*—the beneficiary of the regulation—gains more than *A*—the regulated party—loses. But if that is the case, he noted:

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249. Dunham, *supra* note 210, at 135.

250. *Id.* The other possible rationale mentioned by Dunham also drew on Coase. In language virtually identical to that used by Coase, Dunham suggested that the reluctance to broaden the law of nuisance could have been because judges understood the reciprocal nature of harm and its implications—that one cannot label any particular party as *the* cause of the harm. See Dunham, *Promises*, *supra* note 210, at 134–35; Coase, *supra* note 1, at 2. Further evidence for Coase’s influence on Dunham comes from the fact that Dunham also noted, as Coase had done, that a single owner of affected parcels of land would also efficiently resolve the problem. See Dunham, *Promises*, *supra* note 210, at 137–38.

251. See Dunham, *Promises*, *supra* note 210, at 135.

252. Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of “Just Compensation” Law*, 80 HARV. L. REV. 1165, 1176 n.23 (1967). Michelman received his LL.B. from Harvard Law School. *Id.* at 1165.

253. Douglas Ayer, *Allocating the Costs of Determining “Just Compensation.”* 21 STAN. L. REV. 693 (1969). Ayer received his LL.B. from Yale Law School in 1962. *Id.* at 693.

254. See generally Michelman, *supra* note 252; Ayer, *supra* note 253.

255. Michelman, *supra* note 252, at 1175.

It might, then, be argued that the [regulatory] measure is unnecessary because, if its premises are sound, we should expect the neighbors to offer *A* an acceptable sum in return for his agreement to cooperate. Conversely, the very fact that no such transaction has spontaneously evolved may be said to prove that *A*'s operation . . . is efficient.<sup>256</sup>

Coase's negotiation result, then, suggests that takings are inefficient because all efficiency-enhancing moves would already have been made. Michelman's response was that Coase's result is "imperfect" because various impediments to the smoothly functioning negotiation process envisioned by Coase's result—including strategic behavior by those involved and "the side costs of drafting agreements, checking on their legality, and so forth"—may preclude successful negotiation, even if the taking is transferring resources to a higher-valued use.<sup>257</sup> Because these impediments prevent the parties from reaching an agreement, said Michelman, "a government's regulatory activity may claim an efficiency justification."<sup>258</sup> Thus, where Coase had shown that regulatory remedies were unnecessary in a world of zero transaction costs, Michelman argued that, through its negation, his negotiation result provided a rationale for the *need* for government regulation, including takings, in order to promote efficiency.<sup>259</sup>

While Michelman had argued that regulatory takings *may* be efficient—that the Coase theorem cannot, a priori, provide the basis for an argument that they are not—Ayer, who had been a student of Calabresi's at Yale,<sup>260</sup> went the further step of suggesting that the *existence* of eminent-domain power was *an efficient response* to the problems associated with consummating Coasean bargains in cases where government wished to acquire private land for public purposes. Ayer's rationale for this belief, interestingly enough, was grounded in the primacy of the market.<sup>261</sup> He noted that the law of eminent-domain "allows condemnors to substitute a judicial proceeding for a market transaction as a means of acquiring property."<sup>262</sup> Yet, he continued, given that the market is the usual mechanism for transferring property in the U.S., why is it in some cases "rejected in favor of that effected by the eminent domain power"?<sup>263</sup>

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256. *Id.* at 1175.

257. *Id.* at 1175–76. Michelman noted that Coase himself had pointed to certain of these impediments, and he also mentioned problems related to coordinating members of an affected group to bargain in such situations, citing Calabresi, *The Decision for Accidents*, *supra* note 5; ANTHONY DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* 173–74 (1957).

258. Michelman, *supra* note 252, at 1175.

259. *See generally id.*

260. Letter from Calabresi, *supra* note 154.

261. Ayer, *supra* note 253, at 693.

262. *Id.*

263. *Id.*

To answer this question, Ayer took as his example a situation in which the government wishes to undertake a large public-works project, one that entails the acquisition of several parcels of property.<sup>264</sup> The property owners, he said, may see the opportunity for windfall gains from this process and so respond by over-stating the value of their property.<sup>265</sup> Their goal, Ayer argued, is to get as large a windfall as possible without setting the price so high that the government abandons its plan to purchase the party's land for the project.<sup>266</sup> Invoking Calabresi's 1968 discussion of Coase's result, and employing language strikingly similar to that of Calabresi, Ayer argued:

If there were no transaction costs, no legal impediments to bargaining, and the windfall-seeking condemnees [sic] were all rational, they could work out among themselves a contractual arrangement that would ensure that their demands did not exceed, individually or in the aggregate, the monopoly tolls that the condemnor could pay and still benefit from the public improvement.<sup>267</sup>

Like Michelman, then, Ayer was arguing that the Coase theorem implies that the use of eminent-domain power is unnecessary.<sup>268</sup>

It was only in answering his "why not the market?" question that Ayer finally invoked Coase directly, but his focus was on Coase's discussion of transaction costs and their impacts rather than on the smoothly operating negotiation process of the Coase theorem.<sup>269</sup> What Ayer took from this was that "transaction costs and perhaps also irrational condemnees who could not perceive the advantage of entering into such an arrangement" would pose significant problems when it came to arriving at negotiation solutions to these government purchases.<sup>270</sup> To overcome these problems and achieve an efficiency-enhancing resource transfer, Ayer said, "some form of governmental

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264. *Id.* at 694.

265. *Id.*

266. *Id.*

267. *Id.* at 696. See also Calabresi, *Transaction Costs*, *supra* note 129, at 68, quoted *supra* p. 26.

268. Ayer, *supra* note 253, at 696.

269. *Id.* at 696. See also Coase, *supra* note 1, at 17-18.

270. Ayer, *supra* note 253, at 696. Ayer's discussion of transaction costs closely parallels Coase's 1959 and 1960 treatments of the subject. *Id.* Ayer said that transaction costs here "include such items as identifying the windfall-seeking condemnees, getting them together, obtaining accurate information about the extent of the available windfalls, negotiating each party's share in the monopoly tolls the condemnor would pay, and so forth." *Id.* at 696 n.10. Yet he did not cite Coase here. *Id.* Windfall-seeking, more commonly known as rent-seeking in the economics literature, was later argued to be a phenomena that invalidated the Coase theorem. Yet, Coase had explicitly ruled out rent-seeking in his original statement of the assumptions attending the negotiation result. See Culho Jung, Kerry Krutilla, W. K. Viscusi & Roy Boyd, *The Coase Theorem in a Rent-Seeking Society*, 15 INT'L REV. L. & ECON. 259 (1995); Ronald H. Coase, *The Federal Communications Commission*, 2 J.L. & ECON. 1, 27 n.54 (1959); Steven G. Medema, *Comment: The Coase Theorem, Rent Seeking, and the Forgotten Footnote*, 17 INT'L REV. L. & ECON. 177 (1997).

coercion seems required,” and his view was that “the eminent-domain power can be seen as serving this purpose.”<sup>271</sup> That is, eminent-domain power facilitates the results associated with Coasean bargains in instances where these bargains are not feasible and so works as a legal rule that could be employed to “mimic the market” in situations where the market performed sub-optimally. In essence, then, the Coase theorem—and, in particular, the divergences between the real world and the world contemplated by the Coase theorem—was being used by Ayer to provide a rationale for the existence or evolution of eminent-domain power.<sup>272</sup>

At the same time that Ayer was appealing to the Coase theorem to justify government’s eminent-domain power, Gerald Wright was employing its logic in the area of legal procedure—to provide a justification for class-action lawsuits.<sup>273</sup> Wright, a student at Stanford Law School who was simultaneously pursuing a Ph.D. in economics,<sup>274</sup> was sympathetic to the basic efficiency-related goal of internalizing costs and argued that class-action lawsuits may be an efficient response to a situation in which the actions of one party impose costs on a *host* of others, as in the case of a diffuse pollution externality. In making his case for this position, Wright presented a lengthy explication and discussion—ranging over some twenty pages—of Coase’s analysis, the most extensive by far in the legal literature to that point.<sup>275</sup>

Echoing a theme that was prominent in economists’ discussions of Coase’s analysis during the 1960s,<sup>276</sup> Wright said that Coase “seemed to have . . . reaffirmed” the “efficacy of the free market” when he laid out the negotiation result and its attendant invariance proposition, along with his contention that, in the face of positive bargaining costs, efforts to internalize costs by imposing them on those traditionally seen as the cause of the harm “do not necessarily lead to an optimum solution.”<sup>277</sup> Though he found Coase’s negotiation analysis “useful” as a demonstration of the idea that alternative assignments of rights will not affect output levels, Wright also considered the argument “incomplete,” in that the presence of transaction costs would “preclude any ‘bargaining’” for “most externalities,” meaning that the party to whom rights are assigned would indeed impact the allocation of resources.<sup>278</sup> The insight into Coase’s analysis provided by Wright’s ec-

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271. Ayer, *supra* note 253, at 696.

272. *Id.*

273. Gerald A. Wright, *The Cost-Internalization Case for Class Actions*, 21 STAN. L. REV. 383 (1969).

274. Wright had previously earned a B.A. in economics from Harvard. *Gerald A. Wright Memorial Fund*, CHARITYSMITH, <http://www.charitysmith.org/endeavors/gwright/> (last visited Oct. 26, 2014).

275. Wright, *supra* note 273, at 383–84.

276. See Medema, *Rethinking Market Failure*, *supra* note 4.

277. Wright, *supra* note 273, at 386.

278. *Id.*

onomics training appears to be on display in his assessment of the problems posed by transaction costs. Wright argued that even the slightest transaction costs, as distinct, for example, from the larger information problems, etc. pointed to by the torts commentators, could derail Coase's negotiation result:

The crucial assumption at this stage of the analysis is that bargaining is costless—that there are no lawyers, arbitrators, cost-benefit studiers, or others to reduce the amounts of money that can be transferred among the parties. In fact, if any amount of economic energy is spent on the bargaining process, there has been a cost that will prevent the parties from reaching the theoretical optimum. Since bargaining is usually difficult and costly, it is necessary to determine what effect that difficulty will have on the efficient use of resources.<sup>279</sup>

Wright's concern about even the smallest of transaction costs stood in stark contrast to those of many other legal commentators, who were willing to countenance Coase's result, even in the presence of positive, but low, levels of such costs.<sup>280</sup>

What, then, does all of this have to do with class-action lawsuits? Wright noted that when transaction costs are positive, one definition of rights may be more likely than others to facilitate bargaining.<sup>281</sup> If, for example, there is a single polluter and several parties who are harmed by the pollution, negotiations are more likely to be initiated if the victims are given the right to be free from harm. The polluter will then have an incentive to initiate negotiations with the victims to reach a mutually-beneficial settlement. If the polluter was instead granted the right to continue with its emissions, it would be more difficult for the several victims to coordinate the initiation of negotiations.<sup>282</sup> The benefit of allowing class-action lawsuits, said Wright, is that the class-action collapses the externality to two parties<sup>283</sup> and, in the process, "reduces bargaining costs between the polluter and the

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279. *Id.* at 388.

280. *Id.* The problems with the bargaining solution were not limited, for Wright, to transaction costs. Again drawing on his economics training, Wright invoked the work of economists F.T. Dolbear and E.J. Mishan to argue that, even when bargaining is costless, if consumers are party to the externality, income effects will generate different efficient outcomes, depending on to which party rights are initially assigned, and thus who has to pay the bribes to whom. *See id.* at 386–98; F.T. Dolbear, *On the Theory of Optimum Externality*, 57 AM. ECON. REV. 90 (1967); E. J. Mishan, *Pareto Optimality and the Law*, 19 OXFORD ECON. PAPERS 255 (1967). *See also* Steven G. Medema, *1966 and All That: Codification, Consolidation, Creep, and Controversy in the Early History of The Coase Theorem*, 36 J. HIST. ECON. THOUGHT 271 (2014); Medema & Zerbe, *supra* note 12 (discussing this literature).

281. Wright, *supra* note 273, at 398. This, as we have seen, was a point that Calabresi had emphasized and that eventually gave rise to the idea known as the "normative Coase theorem."

282. *Id.* at 403–04. Calabresi had previously pointed to problems with free-riding behavior in a Coase theorem context. *See supra* note 128 and accompanying text.

283. Wright, *supra* note 273, at 398.

pollutees, and also among the pollutees themselves.”<sup>284</sup> Wright did not suggest, at this point, that it makes no difference to which party rights are assigned since, even in a class-action situation, transaction costs are at best reduced, not eliminated.<sup>285</sup> Rather, he believed that, where rights are assigned to the victims, the parties are more likely to negotiate as Coase contemplated. Again, the logic behind this argument is that it is easier for the single party to initiate negotiations.<sup>286</sup>

Coase’s negotiation result, then, provided the rationale for Wright’s defense of class actions, which can be seen as an efficient procedural response to the existence of significant transaction costs and one that can facilitate the Coasean negotiation process, just as, at the hands of Michelman and Ayer, it provided a rationale for eminent-domain power and regulatory takings. In each case, the legal measure in question was described as an efficient or efficiency-enhancing response to the presence of costly negotiation—the one significant difference being that, for Wright, the effect was to stimulate negotiation *à la* Coase rather than to provide a “regulatory” alternative to negotiation failure.

#### VII. TRACKING THE COASE THEOREM: MYTHOLOGIES OF CHICAGO AND OF ECONOMICS IMPERIALISM

To this point, this Article has devoted a good deal of effort addressing the question of how Coase’s negotiation result was treated by legal scholars during the 1960s. What this Article has not examined in any significant way is the question of how the Coase theorem *gained traction*—that is, by what processes or mechanisms this idea was diffused into the legal community, garnering more and more references and discussions as the decade wore on, and what this tells us about the early history of the economic analysis of law. This history is typically told as a Chicago story, though one in which Yale played a role, and it is also often characterized as an early instance of “economics imperialism,” with “Chicago school” economists and fellow travelers attempting to infuse legal analysis with economic thinking and even to colonize the field. While there can be no doubt that the Coase theorem is most closely associated in the professional mind with the “Chicago school” and with the “economics imperialism” that emanated in part from Chicago, the study of its diffusion into the legal literature suggests that there is a significant element of myth in each of these traditional stories.

With respect to the “economics imperialism” question, when it came to applying the Coase theorem to legal issues, the economists

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284. *Id.* at 403.

285. *Id.*

286. *Id.* at 404.



were almost nowhere to be found during the 1960s.<sup>287</sup> Though they were busy discussing various implications of Coase's analysis, including the negotiation result, for the theory of and policy making related to externalities, they were not applying the Coase theorem to issues that would traditionally fall into the legal realm. While the economists were to join the legal fray not long after the period examined here, the fact is that it was the lawyers who were leading the charge in bringing the Coase theorem into legal analysis—including using it as a justification for the adoption of legal rules that would satisfy the dictates of efficiency—during the 1960s.

As Table 1 (below) makes clear, the story of how the Coase theorem wove its way into the legal literature is also far from being a Chicago-centric story. In terms of the raw data, there were far more references to Coase's negotiation result outside of Chicago than within it. Coase's result was treated in roughly equal measure by individuals affiliated with Chicago, Yale, and Stanford—with smattering of attention from scholars at other institutions. And, as one can gather from the previous discussion, it is fair to say that the Chicago treatments, taken as a group, were not significantly more enthusiastic about the theorem than those coming from scholars at other schools.<sup>288</sup> But even this data is misleading, in that it masks the chains of influence that reveal the true importance of Yale—and Calabresi in particular—in the Coase theorem's diffusion.

There can be no question that, when it comes to the published record at least, Calabresi was the foremost exponent of the Coase theorem among legal scholars during the 1960s.<sup>289</sup> That he was an economics undergraduate who received his legal education at an institution with a significant Realist-infused law and economics heritage

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287. See Medema, *Rethinking Market Failure*, *supra* note 4; Medema, *supra* note 154 for discussions of how economists treated Coase's negotiation result during the 1960s. Suffice it to say that the economists were not applying the theorem to issues that traditionally fell into the *legal* realm.

288. Interestingly, individuals with close connections to three schools—Chicago, Virginia, and the London School of Economics—were responsible for a significant proportion of the citations to Coase's analysis within economics in the first half of the 1960s. It should also be noted that there were five other references to Coase's article that, directly or indirectly, emanated from the Law School at Chicago during this period, but none of them discuss Coase's negotiation result. See Harold P. Green, *Technology Assessment and the Law: Introduction and Perspective*, 36 GEO. WASH. L. REV. 1033 (1968); David P. Currie, *Review of Water Law, Planning & Policy (Cases and Materials)*, by Joseph L. Sax, 56 CALIF. L. REV. 1811 (1968); David P. Currie, *The Federal Courts and the American Law Institute: Part II*, 36 U. CHI. L. REV. 268 (1969); Note, *Federal Regulation of Air Transportation and the Environmental Impact Problem*, 35 U. CHI. L. REV. 317 (1968); G. E. Hale & Rosemary D. Hale, *Cost-Benefit in Court*, 38 GEO. WASH. L. REV. 83 (1969).

289. Only economists James Buchanan of the University of Virginia and Harold Demsetz of the University of Chicago come close to matching Calabresi when it comes to the number of treatments of Coase's negotiation result in the 1960s, but they were working on topics more traditionally "economic" in nature. See, e.g., Demsetz, *supra* note 135.

certainly accounted for some, if not much, of Calabresi's willingness to engage, countenance, and even embrace Coase's negotiation result. His coursework in tort law and the economic ring that certain questions of tort law had for him gave Calabresi the stimulus to develop a deterrence-based approach to accidents grounded in economic logic. The legacies of scholars such as Thurman Arnold and Walton Hamilton, both of whom emphasized the significant nexus between law and economics, made Yale a receptive environment for working out these ideas.<sup>290</sup>

Calabresi's influence goes much further than this, however, for there can be little question that much of the use of Coase's analysis at *and beyond* Yale during this period was attributable, directly or indirectly, to Calabresi. His several articles treating Coase's result exposed many scholars to it, but as Table 1 illustrates, the chain of influence here goes far beyond other scholars reading through Calabresi's articles and deciding to incorporate Coase's insight into their own analysis. Ayer and Onek, for example, were Calabresi's students, and Onek spoke explicitly of the substantial debt that his analysis owed to Calabresi.<sup>291</sup> Calabresi's influence is further exemplified in the propensity for Yale-associated authors to cite Calabresi more prominently than Coase when discussing the negotiation result (with the reverse holding for scholars associated with Chicago). Given that it was Calabresi, and not Coase, who was making regular use of the negotiation idea and of Coase's contribution,<sup>292</sup> it may also be that, inside and outside of Yale, Calabresi was as closely identified with Coase's result at that time as was Coase himself—particularly as this result had not yet come to be widely known as the “Coase theorem.”<sup>293</sup>

Moving a (half) step beyond Yale, it is almost certainly Calabresi's influence that explains what is perhaps the most surprising element of this data—the significant number of references to the Coase theorem that came out of Stanford during this period. Franklin, who taught torts at Stanford during the 1960s, kept up with the output of his good friend Calabresi and encountered Coase's analysis through Calabresi's debate with Blum and Kalven—the articles from which, along with Coase's article, are cited in his 1965 analysis of products liability.<sup>294</sup> Ayer, who graduated from Yale Law School in 1962 and was a student of Calabresi's during his time there, joined the Stanford faculty in

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290. *Interview, supra* note 21.

291. Onek, *supra* note 152, at 603.

292. Coase did not publish another word on this subject during the 1960s.

293. It is also noteworthy that we observe in this literature the Yale tendency to move quickly to a focus on the influence of transaction costs and attendant (positive) implications for government intervention—a position that was to distinguish the Yale law and economics approach from the Chicago approach in the coming years.

294. Letter from Franklin, *supra* note 154. *See also* Franklin, *When Worlds Collide, supra* note 152, at 1005 n.183.

1967. It is likely, then, that it was Franklin and Ayer—and thus, in directly, Calabresi—who were responsible for exposing Stanford students Atwood, Childs, and Wright—all of whose articles were published in 1969—to Coase’s negotiation result.<sup>295</sup>

The one other piece of interesting information that emerges from this contextual analysis is that *students* at Chicago, Yale, and Stanford were being exposed to the Coase theorem. The law reviews of all three schools featured student notes making reference to Coase’s result during the late 1960s—one at Chicago and two apiece at Yale and Stanford. This is not to say that the students were being “taught” the Coase theorem; we have no records of student class notes that would support such a claim, though retrospective comments by Chicago students suggest that the theorem was being taught at Chicago, at least.<sup>296</sup> As for the Yale and Stanford students—Woodward, Onek, Atwood, and Wright—it may simply be that they encountered the theorem in the research done for their respective articles. But it seems likely that the students first encountered Coase’s result in their courses—perhaps in reading the debates between Blum and Kalven and Calabresi, though it is possible that the students were also asked to read Coase. But they *were* being exposed to Coase’s result and took it seriously enough to incorporate it into their own scholarship. The fact that Childs, a student at Stanford, considered this result “a well-accepted proposition” speaks to the inroads that the Coase theorem was making in legal training.<sup>297</sup>

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295. Ayer was at that time “interested in seeing how economic theory could be used to address legal problems,” though it was not long before his focus shifted to the study of legal history. Letter from Douglas Ayer to Steven Medema (Sept. 6, 2012) (on file with author). See also Douglas Ayer, *In Quest of Efficiency: The Ideological Journey of Thurman Arnold in the Interwar Period*, 23 *STAN. L. REV.* 1049 (1971).

One other possible line of influence here is Aaron Director, who arrived at the Hoover Institution in 1965 and also had an office at the Stanford Law School. It was Director who accepted Coase’s article for publication in the *Journal of Law and Economics*, helped to recruit him to the Law School at Chicago, and first called Calabresi’s attention to Coase’s work. It is not beyond the realm of possibility, then, that Director played a role in the diffusion of Coase’s ideas at Stanford, but there is no evidence to support this.

296. See, e.g., George L. Priest, *The Limits of Antitrust and the Chicago School Tradition*, 6 *J. COMPETITION L. & ECON.* 1, 5 (2010).

297. Childs, *supra* note 235, at 1710.

TABLE 1  
DATA ON LAWYERS CITING COASE'S NEGOTIATION RESULT

Name	Year	Affiliation	Education	Calabresi Tree
Atwood <sup>298</sup>	1969	Stanford*	Stanford	+
Ayer	1969	Stanford	Yale	+
Blum & Kalven	1964 etc.	Chicago	Chicago	
Bowman	1966	Yale	Vanderbilt (Econ.)	+
Calabresi	1964 etc.	Yale	Yale	+
Childs	1969	Stanford*	Stanford	+
Christensen	1968	Chicago*	Chicago	
Dunham	1965	Chicago	Columbia	
Woodward	1968	Yale*	Yale	+
Franklin	1966	Stanford	Cornell	+
Katz	1969	Harvard	Harvard	
Keeton	1969	Texas	Texas	
Kessler	1967	Yale	Berlin	+
Kitch	1968	Chicago	Chicago	
Michelman	1967	Harvard	Harvard	
Onek	1967	Fed Appeals Ct Clerk	Yale	+
Pasley	1969	Cornell	Cornell	
Weiler	1967	Toronto	Toronto	
Wright	1969	Stanford*	Stanford	+
<b>Affiliations**</b>				
Chicago	4			
Yale	5			
Stanford	5			
* Student.				
**These affiliations mask the fact that Bowman and Kessler (1938–47) had previously taught at Chicago and Ayer did his law degree at Yale in the early 1960s. Onek is counted for Yale because the article was written while he was a student at Yale Law School and published only months following his graduation.				

### VIII. CONCLUSION

Although Ronald Coase noted much later in his career that his work in law and economics was targeted at economists and that he had “no interest in lawyers or in legal education,”<sup>299</sup> legal scholars were quick to pick up on the implications of his negotiation result for legal analysis. One message that emerges from this history is the overly simplistic nature of stories that attempt to paint the origins of the economic analysis of law within the frame of “economics imperial-

298. See, *infra* note 300.

299. Kitch, *supra* note 2, at 192.

ism.” The diffusion of Coase’s negotiation result into the legal literature and legal analysis generally was the product of a work undertaken by *legal scholars*, largely outside of the University of Chicago, who were bringing economic analysis, including Coase’s result, to bear on a wide range of legal issues. Calabresi’s role in all of this was central, of course, but his message did not fall on deaf ears. The “revolution” that the economic analysis of law engendered was still some years off, but the idea that economic analysis could inform legal thinking was beginning to gather steam within the legal community, and the Coase theorem was very much bound up within these formative steps.

One of the most notable aspects of the 1960s discussions of Coase’s negotiation result is that the legal scholars who took it up appear to have accepted its basic theoretical validity. With only two exceptions (one—Calabresi’s—soon recanted), the objections raised went not to whether Coase’s conclusion followed logically from his assumptions, but instead were made on other grounds—mainly relevance/applicability and justice/equity. Most legal scholars at this time were not equipped to debate technical points of economics and perhaps, as a result, did not feel themselves qualified to challenge the economist’s authority on this theoretical front, even as they *did* question the Coase theorem’s applicability to the legal issues with which they were grappling.<sup>300</sup> But then, even the economists themselves had raised very little in the way of theoretical objections to Coase’s result during the first half of the 1960s,<sup>301</sup> so in that respect the reaction within the legal community was not so different from that within economics. Though the state of play on this front would change dramatically during the 1970s, the perceived correctness of Coase’s result circa the late 1960s

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300. The only other challenge (besides Calabresi’s) to the theorem’s theoretical validity that was raised in the legal literature during this period came from Stanford law student James Atwood, and the nature of Atwood’s challenge is indicative of why lawyers may have been reluctant to challenge the economist on technical points of economic theory, such as those underlying the Coase theorem. In it, Atwood argued that Coase’s claim, that outcomes would be independent of initial assignments of liability in a world of costless transacting, was in error because it failed to account for one class of cases: “When the harm to a sensitive use is less than would be the cost of the offending user’s eliminating the offensive part of his use, the ultimate result will depend very much on whether liability is imposed. If the offensive user is not liable he will continue his use totally unaffected by the sensitive users harm. Only if he is found liable will there be an adjustment among the parties.” James R. Atwood, *An Economic Analysis of Land Use Conflicts*, 21 STAN. L. REV. 293, 298 n.18 (1969). Atwood’s argument, however, was off base. If the offending party is not liable, the victim will indeed continue to suffer the damages, as Atwood pointed out. *Id.* But if the offending party *is* made liable, he will not, as Atwood implies, cease to engage in the offending acts. Rather, since the damage done is less than the cost of mitigation, the offending party will bribe the victim to allow him to continue to engage in the offending act, since that is the course of action that provides the offending party and the victim with the greatest net benefit.

301. See Medema, *Rethinking Market Failure*, *supra* note 4, at 1–2.

left only the issue of real-world applicability standing between the Coase theorem and law's irrelevance.

The lawyers' skepticism about translating Coase's insight to the real world was driven by the belief that there are likely to be various impediments, often serious, to a smoothly functioning negotiation or market process—impediments that now fall under the vast umbrella of transaction costs. It is noteworthy that, though Coase himself had assumed that the costs of transacting are zero when fashioning his negotiation result, there was a willingness among legal scholars during this period to break from Coase's assumption and to allow that the results contemplated by the Coase theorem could obtain in the presence of at least some positive level of such costs. But even with this allowance, the perception was that the actual magnitude of these costs in the real world would tend to pose an insuperable barrier to Coasean solutions in many, if not most, instances—though, as we have seen, the opinions here were by no means uniform.

The relevant question points us to what is perhaps the most distinctive feature of the lawyers' discussion of Coase's negotiation result during the 1960s: it focused largely on the issue of invariance, with relatively little attention paid to questions of efficiency. This makes for an interesting contrast with the economists who, during this same period, were focused almost solely on the Coase theorem's efficiency proposition and gave relatively little attention to the invariance issue.<sup>302</sup> The explanation for this dichotomy almost certainly lies in the respective concerns of these two groups. Economists, as we have noted, did not see in Coase's analysis an alternative lens through which to view questions of legal theory; indeed, outside of antitrust and certain regulatory matters, the economists of this period paid scant attention to legal issues.<sup>303</sup> What the economists saw, instead, was a challenge to the Pigovian tradition in the economic theory of externalities (Coase's intended target), which viewed direct government intervention—e.g., taxing or regulating the offending activity—as *necessary* to achieve efficient resource allocation. Coase had argued that these instruments are unnecessary for the attainment of efficiency, at least in the frictionless world of neoclassical economics on which the Pigovian analysis was based. For economists enamored with Coase's result, then, the ability of private action to generate an efficient resolution of externality problems was the big prize at this time, and the idea that the outcome would be invariant across alternative legal-rights structures was of decidedly lesser importance.

In contrast, the focus of the legal scholars was on issues germane to *law*, including the instrumental question of the impacts associated

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302. Medema, *supra* note 280.

303. It was not always so, as a glance at the law and economics literature of the inter-war period reveals. This was the heyday of American institutional economics, which had close links with Legal Realism.

with alternative legal rules—that is, how and why law matters. One could certainly argue—and Calabresi did—that efficiency concerns should be one aspect of this analysis. But the economic analysis of law was still very much in its infancy during this period, and efficiency was not prominently on the radar of legal scholars. It was in its suggestion that the particulars of law are, in essence, irrelevant (the invariance claim) that Coase’s result posed a significant challenge to traditional legal thinking. Interestingly, those lawyers who *did* broach the subject of efficiency were almost always those who had an economics background—Calabresi being only the most prominent example. And in some ways, at least, this law–economics dichotomy remains in place, as evidenced in recent conversations between the present author and two individuals who have long and intimate associations with the Chicago school tradition—one an economist and the other a legal scholar.<sup>304</sup> The economist argued that the Coase theorem is all about the efficiency proposition, and that the invariance issue is a “red herring.” The legal scholar asserted just the opposite—that the main message of the Coase theorem is the invariance proposition. All of this is indicative of the rather different messages that different audiences took from the Coase theorem during the 1960s and continue to take from it today.

When it came to the particulars of Coase’s negotiation result, two aspects of the legal discussion stand out. First, as already noted, the legal scholars were willing to countenance Coase’s result in the presence of some positive level of transaction costs. Second, as emphasized in the discussion of products liability, Coase’s result was seen as the basis for the claim that, in theory, markets would internalize relevant costs in invariant fashion when the parties involved are in an existing contractual or market relationship. Each of these claims marked a departure from Coase’s own discussion, a fact of which the authors seem to have been unaware. Beyond that, however, the former claim suggests a version of Coase’s result that does not pass the test of economic logic while the latter is oblivious to the long-standing acceptance of the pre-existing bargaining case result. It is tempting to ascribe these moves to the authors’ lack of familiarity with the details of economic theory. But whatever the underlying explanation, the fact remains that these larger classes of legal–economic interactions were now identified with Coase’s result and so had the effect of broadening the domain of issues to which the Coase theorem was said to apply. And given the almost universally accepted elementary-price theory underlying the pre-existing bargaining result, this may have had the further effect of solidifying the confidence in the theoretical correctness of Coase’s insight.

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304. These comments emerged in e-mail conversations with these two scholars during 2012. We will preserve their anonymity here.

While some of these details may strike the reader as just so much minutia, they are actually important moments in Coase theorem history. The theorem was inching its way onto the legal landscape,<sup>305</sup> with an imprint that extended well beyond Chicago—though the boundaries during this period remained fairly narrow when compared with the phenomenon that the theorem became over the course of the next decade. The treatment accorded to transaction costs; the envelopment of the pre-existing bargaining situations into the Coase theorem's domain; the respective efficiency-invariance emphases of economists and lawyers; and the set of problems that Coase's analysis was used to address, reveal unmistakably that the Coase theorem was not a "result" that was simply lifted from the pages of *The Problem of Social Cost* and analyzed and applied by other scholars. Instead, it was an idea whose meaning and content, range, and domain were being *worked out* during this formative period.

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305. The inroads that the Coase theorem was making into legal thinking is perhaps best evidenced by a situation in which it was not applied—an article by G.E. Hale and Rosemary D. Hale in the *George Washington Law Review* on the use of cost-benefit analysis in the courts. G.E. Hale, a graduate of Harvard and University of Chicago Law Schools and Rosemary Hale, a lecturer in economics at Lake Forest College, discussed *United States v. Container Corporation of America*, 393 U.S. 333, 337 (1969), from which emerged a court finding that price communication between competing firms was unlawful. In their discussion of this case, Hale and Hale noted that because information acquisition was unlikely to be attended by externalities, private and social cost are likely to be identical in this case and, as such, it was "therefore unnecessary to consider application of the Coase theorem which states that private and social costs are the same regardless of 'externalities.'" Hale & Hale, *supra* note 288, at 87 n.21. That Hale and Hale would even mention that they need *not* bring in the Coase theorem suggests the extent to which the theorem was becoming part of legal analysis. See *generally id.*