FOREWORD
ADVANCES IN THE BEHAVIORAL ANALYSIS OF LAW: MARKETS, INSTITUTIONS, AND CONTRACTS

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The collection of articles in this Special Issue is based on an international conference on *Advances in the Behavioral Analysis of Law: Markets, Institutions, and Contracts* that took place on December 8, 2009 at the University of Haifa Faculty of Law in Israel. The conference addressed cutting-edge legal issues at the intersection of law, economics, and psychology from a diverse set of viewpoints, bringing together scholars engaged in both theoretical and experimental behavioral analyses of law.

The behavioral analysis of law—the application of empirical behavioral evidence to legal analysis—has become increasingly popular in legal scholarship in recent years.[1] This approach provides an explicit account of legally relevant behavior based on empirical research instead of intuition or theory alone. Drawing on the extensive findings of behavioral decision research, the psychology of Judgment and Decision Making (JDM), and related fields, the behavioral approach thus offers an empirically-based middle ground between the theoretical abstractions of the rational-actor model used by traditional law

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1. For instance, a search in the "Law Reviews and Journals, Combined" database in LexisNexis, as of March 17, 2011, for the terms "behavioral law and economics" or "behavioral analysis" yielded 944 results, 463 of them from the last 5 years. *See also* Gregory Mitchell, *Taking Behavioralism Too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of Law*, 43 WM. & MARY L. REV. 1907, 1909–10 & nn.5–6 (2002); Cass R. Sunstein, *Behavioral Law and Economics: A Progress Report*, 1 AM. L. & ECON. REV. 115, 115 (1999) (describing a "flood" of behaviorally-oriented legal research already in 1999). For some additional reviews and broad applications of behavioral findings to the law, see, e.g., Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051 (2000); Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998) (showing the broad range of behavioral application in the legal literature at the time, even before this approach had become widely popular).

and economics and the implicit, intuitive, and unstructured view of human behavior of traditional legal scholarship.[2]

More specifically, behavioral decision research emphasizes that humans are "boundedly rational"—they possess limited cognitive resources and are affected by motivation and emotion.[3] Sometimes, they engage in formal, effortful, and time-consuming judgment and decision-making.[4] More commonly, however, to survive and function in a complex world, individuals use highly adaptive and often useful mental and emotional heuristics when making judgments under uncertainty; they also rely extensively on situational cues to guide their choices.[5] However, heuristic judgment and cue-dependent choice also lead to systematic and predictable deviations from strictly rational behavior.[6]

Yet despite its many recent contributions, current behavioral-legal scholarship exhibits certain limitations, a number of which are addressed by articles in this issue. For one, only a limited number of legal scholars examined the interaction between behavioral deviations from rational action and the operation of markets, firms, and similar institutions.[7] This shortage stems, at least in part, from a common belief in the power of competitive markets and those business associations that operate within them to overcome deviations

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2. For a detailed exposition, see generally Avishalom Tor, *The Methodology of the Behavioral Analysis of Law*, 4 HAIFA L. REV. 237 (2008).

3. The concept of bounded rationality was originally developed by Herbert A. Simon. *See generally* Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q.J. ECON. 99 (1955); Herbert A. Simon, *Rational Choice and the Structure of the Environment*, 63 PSYCHOL. REV. 129 (1956). In Simon's terminology, however, bounded rationality denoted only the cognitive limitations of the human mind, while the present usage is broader, referring to the various inherent limitations of human judgment and decision-making. *See* Avishalom Tor, *The Fable of Entry: Bounded Rationality, Market Discipline, and Legal Policy*, 101 MICH. L. REV. 482, 485 & n.4 (2002) (explaining this broader usage of the term). *See also* Douglas MacLean, *Some Morals of a Theory of Nonrational Choice*, *in* JUDGMENTS, DECISIONS AND PUBLIC POLICY 46, 48 (Rajeev Gowda & Jeffrey C. Fox eds., 2002) (noting that psychological evidence on nonrational judgment and decision behavior present a qualitatively deeper challenge to the rationality assumption than the one posed by Simon's early bounded rationality view).

4. *See* Daniel Kahneman & Shane Frederick, *Representativeness Revisited: Attribute Substitution in Intuitive Judgment*, *in* HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT 49, 50 (Thomas Gilovich, Dale Griffin & Daniel Kahneman eds., 2002).

5. *See, e.g.*, BOUNDED RATIONALITY: THE ADAPTIVE TOOLBOX (Gerd Gigerenzer & Reinhard Selten eds., 2001); JOHN W. PAYNE, JAMES R. BETTMAN & ERIC J. JOHNSON, THE ADAPTIVE DECISION MAKER 2 (1993) (developing the thesis that the use of heuristics and varying decision strategies "is an adaptive response of a limited-capacity information processor to the demands of complex decision tasks").

6. *See* Tor, *supra* note 2, at 245–72 (2008) (reviewing findings on judgment and choice, respectively).

7. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001); Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135 (2002); Robert Prentice, *Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for Its Future*, 51 DUKE L.J. 1397 (2002); Amanda P. Reeves & Maurice E. Stucke, *Behavioral Antitrust*, 86 IND. L.J. (forthcoming 2011); Tor, *supra* note 3; Avishalom Tor, *Illustrating a Behaviorally-Informed Approach to Antitrust Law: The Case of Predatory Pricing*, 18 ANTITRUST 52 (2003).

from rational action.[8] However, while these institutions may sometimes ameliorate or even eliminate behavioral phenomena,[9] at other times, they exacerbate them, introduce additional deviations from rational action, or simply fail to discipline these deviations from rational action, generating effects that behavioral analyses of the law should account for.[10] Notably, behavioral contributions are now common in disciplines such as management and economics that grapple with closely related questions.[11]

In addition, most behavioral-legal analyses have been based on theoretical applications of extant empirical evidence.[12] Yet while this scholarship already has made significant contributions to the law, there is a pressing need for additional, focused, empirical research of behavioral-legal questions. In particular, legal scholarship often stands to benefit from experimental tests that can directly examine legally-relevant behavior while controlling for potential confounds and selection effects.[13] Such experiments, moreover, can also shed light on the psychological mechanisms underlying the behavioral effects, which may be difficult to discern based on field evidence even when they have important policy implications.[14]

The present issue addresses these challenges by bringing together a unique set of wide-ranging contributions from scholars with behavioral expertise and diverse disciplinary backgrounds in law, psychology, and economics. These contributions direct their nuanced inquiries to the interplay of behavioral phenomena, markets, and other legal institutions; a number of them also employ focused experimental tests to generate new, relevant data. Moreover, the articles in this issue address three important areas of behavioral-legal analysis, including litigation and procedure, contracts and market behavior, and the design of the law and legal institutions more generally.

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8. *See* Jolls, Sunstein & Thaler, *supra* note 1, at 1473 ("[L]aw is a domain where behavioral analysis would appear to be particularly promising in light of the fact that nonmarket behavior is frequently involved.").

9. *See* Tor, *supra* note 3, at 562; Avishalom Tor & William J. Rinner, *Behavioral Antitrust: A New Approach to the Rule of Reason after* Leegin, 2011 U. ILL. L. REV. (forthcoming 2011) (manuscript at 55), *available at* http://ssrn.com/abstract=1522948.

10. *See* Tor, *supra* note 3, at 561–67; Tor & Rinner, *supra* note 9 (manuscript at 55–56).

11. For some significant research in these areas, see generally JUDGMENT AND DECISION MAKING RESEARCH IN ACCOUNTING AND AUDITING (Robert H. Ashton & Alison Hubbard Ashton eds., 1995); MAX H. BAZERMAN, JUDGMENT IN MANAGERIAL DECISION MAKING (6th ed. 2005); ADVANCES IN BEHAVIORAL ECONOMICS (Colin F. Camerer, George Loewenstein & Matthew Rabin eds., 2004); ORGANIZATIONAL DECISION MAKING (Zur Shapira ed., 1997); ADVANCES IN BEHAVIORAL FINANCE (Richard H. Thaler ed., 1993); 2 ADVANCES IN BEHAVIORAL FINANCE (Richard H. Thaler ed., 2005).

12. *See* Tor, *supra* note 2, at 274–81; sources cited *supra* note 1.

13. *See* Tor, *supra* note 2, at 281–91; Jeffrey J. Rachlinski, *Gains, Loses, and the Psychology of Litigation*, 70 S. CAL. L. REV. 113 (1996) (combining the analysis of field data with controlled experiments). *See, e.g.*, Avishalom Tor, Oren Gazal-Ayal & Stephen M. Garcia, *Fairness and the Willingness To Accept Plea Bargain Offers*, 7 J. EMPIRICAL LEGAL STUD. 97 (2010) (using simple experimental tests to complement suggestive field data).

14. *See* Tor, *supra* note 2, at 281–91.

In the first area, Eyal Zamir and Ilana Ritov's article on *Notions of Fairness and Contingent Fees* uses experimental tests to show how perceptions of fairness impose a constraint on attorneys' contingent fee arrangements and thus impact the market for legal services.[15] These tests show that high contingent fee rates are considered unfair even when they result in low effective hourly rates, while the opposite holds for low contingent fee rates. Moreover, the effect of the contingent fee rate on the perceived fairness of the arrangement is significantly greater than that of other factors that are equally relevant, including the claimed sum, the probability of recovery, and the hours the attorney works on the case.[16] Somewhat surprisingly, however, the studies also found that the perceived fairness of contingent fee arrangements was not directly correlated to their preferences when choosing between contingent and non-contingent fee arrangements. This finding, in turn, suggests that factors other than clients' preferences—such as attorneys' reputational concerns or legal caps—drive high contingent fee arrangements out of the market even where client and attorney would both have found them attractive.[17] Hence, the absence of such arrangements may reflect a fairness constraint on market transactions rather than those commonly asserted forms of market failure such as imperfect competition or asymmetric information.[18]

Ronen Perry and Dana Weimann Saks follow with their article *Stealing Sunshine*, providing experimental evidence for the efficacy of a trial advocacy technique—the mirror-view of the familiar "stealing thunder" strategy—whereby an attorney discloses early in the trial information that appears advantageous to the other party to mitigate its impact on fact-finders.[19] In a first, exploratory study of this technique, the authors find evidence suggesting that stealing sunshine can mitigate the impact on fact-finders' decisions of positive information about an opponent—that is harmful to the position of one's client—in litigation.[20]

Turning to the second area of behavioral applications, Claire Hill asks in the third article *Why Didn't Subprime Investors Demand a (Much Larger) Lemons Premium?* In her article, she argues that this phenomenon, which had a significant role in generating the recent global financial crisis, resulted from investors' biased incentive structure. Hill points to "herding" among investment managers—who are evaluated vis à vis their peers—and the regret avoidance of individual investors as the most significant factors generating this bias.[21]

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15. Eyal Zamir & Ilana Ritov, *Notions of Fairness and Contingent Fees*, 74 LAW & CONTEMP. PROBS. 1 (Spring 2011).

16. *Id.* at 18–19.

17. *Id.* at 21, 25–29.

18. *Id.* at 30.

19. Ronen Perry & Dana Weimann-Saks, *Stealing Sunshine*, 74 LAW & CONTEMP. PROBS. 33 (Spring 2011).

20. *Id.* at 44–45.

21. Claire A. Hill, *Why Didn't Subprime Investors Demand a (Much Larger) Lemons Premium?*, 74 LAW & CONTEMP. PROBS. 47, 50 (Spring 2011).

Following this analysis, Hill concludes that increased accountability—through norms or regulation—is needed to remedy this bias.[22]

The fourth article, by Shmuel Becher and Tal Zarsky, addresses *Open Doors, Trap Doors, and the Law*. These authors show how legal arrangements that leave doors open—that is, provide a time-limited opportunity to rescind or withdraw from contractual obligations, such as mandatory cooling-off periods or product return policies—generate significant and largely unrecognized social costs that policymakers should take into account.[23] Specifically, these authors argue that open door policies may encourage consumers to overpay for open doors, enter transactions that they otherwise might not have entered, and more.[24] Becher and Zarsky thus suggest that scholars and policymakers direct more careful attention to the hidden costs of open-door policies, which although sometimes beneficial, may require regulatory intervention in certain settings.[25]

The fifth article in the volume and the final one in this area, *Harmful Freedom of Choice: Lessons from the Cellphone Market* by Adi Ayal, argues that the proliferation of service plans and options in the cellular markets harms consumers instead of benefiting them, due to the behavioral effects of excessive choice.[26] Drawing on empirical findings from psychology and economics alike, Ayal asserts that the combined effects of contractual complexity on the one hand, and cellular market characteristics—most notably concentration—on the other hand, generate not only direct consumer harm, but may also diminish competition in the market.[27] Following this analysis, Ayal examines the desirability of alternative approaches to regulatory intervention in the cellular market aimed to address both the consumer protection and antitrust harms of excess choice, concluding that the ultimate verdict on such interventions is unclear and should await further analysis.[28]

In the last area of application, in Yuval Feldman and Shahar Lifshitz's *Behind the Veil of Legal Uncertainty*, the authors argue that legal uncertainty, which is typically viewed as an undesirable, if unavoidable, feature of the law, is in fact sometimes advantageous in a broad array of legal settings.[29] Combining jurisprudential argument with behavioral analysis and experimental demonstrations, the authors show that the law can distort individual choice and that under some circumstances, uncertainty can help individuals act in a non-

22. *Id.* at 61–62.

23. Shmuel I. Becher & Tal Z. Zarsky, *Open Doors, Trap Doors, and the Law*, 74 LAW & CONTEMP. PROBS. 63 (Spring 2011).

24. *Id.* at 82–88.

25. *Id.* at 88–90.

26. Adi Ayal, *Harmful Freedom of Choice: Lessons from the Cellphone Market*, 74 LAW & CONTEMP. PROBS. 91 (Spring 2011).

27. *Id.* at 93–112.

28. *Id.* at 126–30.

29. Yuval Feldman and Shahar Lifshitz, *Behind the Veil of Legal Uncertainty*, 74 LAW & CONTEMP. PROBS. 133 (Spring 2011).

strategic manner, better expressing their genuine preferences, moral perceptions, and true economic interests.[30] However, Feldman and Lifshitz also recognize that a "veil of uncertainty" may not only facilitate genuine choice, but may also undermine the law's ability to guide social behavior through deterrence and incentives as well as its expressive function.[31] The authors thus conclude that while the adoption of uncertainty-promoting law is desirable in certain settings, this approach should be limited to areas where the main function of the law is neither the guidance of ex-ante behavior nor the expression of social values.[32]

And finally, in the seventh article, Amir Licht discusses *Law for the Common Man: An Individual-Level Theory of Values, Expanded Rationality, and the Law*.[33] Drawing on psychological theories of personal values, Licht seeks to outline an analytical framework that draws on the psychological value-based theory to expand and provide content to the familiar economic concept of individual utility.[34] In this approach, personal values, in the sense of the desirable, guide people's judgments and choices in more concrete and specific ways than the abstract goal of utility maximization.[35] After outlining the main characteristics of this value-based theory of expanded rationality, Licht proceeds to show how this theory promotes positive legal analysis, most notably because a better understanding of individuals' view of the desirable helps clarify how and why the law is designed to guide behavior towards socially desirable goals.[36]

Altogether, therefore, the seven articles in this issue reflect new and ongoing developments in the application of behavioral insights and methodology to legal scholarship in key areas of doctrine and policy-making alike. Interestingly, one finds that even while the various articles provide both new empirical data and cutting-edge analyses, they raise at least as many new questions for future legal scholarship as they answer, highlighting the challenges facing an effective behavioral analysis of law and the many contributions it stands to make.

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30. *Id.* at 142–55.

31. *Id.* at 164–72.

32. *Id.* at 169–72.

33. Amir N. Licht, *Law for the Common Man: An Individual-Level Theory of Values, Expanded Rationality, and the Law*, 74 LAW & CONTEMP. PROBS. 175 (Spring 2011).

34. *Id.*

35. *Id.* at 176–92.

36. *Id.* at 203–06.