THE NEW REALISM IN BUSINESS LAW AND ECONOMICS: INTRODUCTION

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Law and economics gained a significant place in legal analysis, both in the academy (in scholarship and pedagogy) and in practice, several decades ago. It is still quite prominent today, but over the years, a new, more nuanced perspective has been gaining ground, a new realism.

To explain the new realism, it is helpful to start with some history. Law and economics, including business law and economics, assumes people are "rational" in some strong and counterintuitive sense of that word. It acknowledges that its assumptions may not be realistic, but it believes that they are useful enough to generate good predictions,[1] and better than alternatives in doing so. Another belief that can fairly be ascribed to the field is a meta-belief that others disputing its assumptions and theories have the burden of proof: the minimum wage surely decreases demand for unskilled workers; higher tax rates surely discourage work. Only the most unambiguous of unambiguous evidence to the contrary could, to perhaps overstate (but only slightly), serve as a basis for policy.[2]

Behavioral law and economics was in part a reaction to law and economics, but went too far in its characterization of behavior as often "irrational."[3] What scholars are increasingly realizing—and sophisticated practitioners have always known—is that a nuanced perspective as to how people and institutions *advance their own interests as they view them* offers the best way to understand how business—contracting, finance, and

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1. MILTON FRIEDMAN, *The Methodology of Positive Economics*, *in* ESSAYS ON POSITIVE ECONOMICS 15 (1966) ("[T]he relevant question to ask about the 'assumptions' of a theory is not whether they are descriptively 'realistic,' for they never are, but whether they are sufficiently good approximations for the purpose in hand. And this question can be answered only by seeing whether the theory works, which means whether it yields sufficiently accurate predictions.").

2. *See* Claire A. Hill, *An Identity Theory of the Short- and Long-Term Investor Debate*, 41 SEATTLE U. L. REV. 474, 478–82 (2018).

3. *See* Claire A. Hill, *Beyond Mistakes: The Next Wave of Behavioral Law and Economics*, 29 QUEEN'S L.J. 563, 564–65 (2004).

business litigation—proceeds.[4] The nuanced perspective is within the rationality paradigm,[5] but is far less "heroic" in its assumptions.[6]

This approach proves to have pedagogical payoffs as well: students can be taught, for instance, that long, complex documentation is a plausible solution to various well-known problems, but that it has evolved, not always for the better, over time. Most tangibly, contracts get longer and longer. The new realism can explain why in a way that more orthodox law and economics cannot.

The "new realism" is not new. Indeed, the term as I am using it includes a voluminous body of scholarship, some squarely within the law and economics tradition, and even more in the law and society/social norms tradition and in work that straddles all these fields.[7] The new realism is a commitment to analyzing real world phenomena using explanations that are, in words (probably mistakenly) attributed to Albert Einstein, "as simple as possible, but no simpler."[8] The methods used are heterogeneous, but all aspire to combine the advantages of law and economics' parsimonious worldview without losing sight of the ultimate goal—to understand what goes on in the real world. And perhaps, in the course of the endeavor, the toolbox—the theories, paradigms, and assumptions used for analyses—can be supplemented or otherwise made more useful.

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4. *See id.* at 592.

5. That the perspective takes rationality as a baseline assumption emphatically does not mean that psychology, or behavioral law and economics, has no role in the analysis. *See id.* at 565, 591–94.

6. For this purpose, "heroic" is not a synonym for praiseworthy—rather, a heroic assumption is not realistic, being too optimistic, too simple, or both. *See* Marc Coleman, *One Heroic Assumption Too Many*, IRISH TIMES (Mar. 23, 2006, 12:00 AM), https://www.irishtimes.com/news/one-heroic-assumption-too-many-1.1031837 [https://perma.cc/C4SR-CZ84]; A. KOUTSOYIANNIS, MODERN MICROECONOMICS 203, 209–10, 212 (1975).

7. The best example squarely within law and economics is Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984). Gilson's piece has been highly influential, and his characterization of lawyers as "transaction cost engineers" is widely used in the field. The influence was immediate, as evidenced by a symposium volume in the Oregon Law Review on the piece, and has continued. Symposium, *Business Lawyering and Value Creation for Clients*, 74 OR. L. REV. 1 (1995). Other work, spanning both law and economics and law and social norms, has been done by Lisa Bernstein, beginning with her paper *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992). Yet another seminal piece, in the law and social norms tradition, is by Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963). Most relevant among the other examples that could be given are articles by the authors in this volume.

8. *In Honor of Albert Einstein's Birthday—Everything Should be Made as Simple as Possible, but No Simpler*, CHAMPIONING SCI., https://championingscience.com/2019/03/15/everything-should-be-made-as-simple-as-possible-but-no-simpler/ [https://perma.cc/6LN3-8784].

This symposium brought together experts who have done theoretical, experimental, or empirical research that shows the payoff to "new realism" in all three spheres: scholarship, pedagogy, and practice.

Some of the articles in this volume address complex business contracts. There are many reasons one might expect them to be written simply and elegantly, and to incorporate the best versions of generally needed clauses.[9] But, as is well known, they are inartful, filled with boilerplate, and indeed, filled with different versions of the same boilerplate. They are also sticky—they change far more slowly than the talent and resources involved in their production would suggest. And finally, given all the time spent on anticipating contingencies, some, if not many, contingencies are nevertheless not satisfactorily addressed, if they are addressed at all. Why? Scott, Choi and Gulati,[10] McClane, Jennejohn, Anderson, and de Fontenay all address these issues.

Griffith considers the lawsuits challenging M&A transactions, and seeks to understand who the plaintiffs are, and what might be motivating them. Afsharipour discusses how identity considerations might affect executives' decisions as to whether and on what terms to have their companies engage in M&A transactions. Nili, noting the crucial role of director independence (and independent directors) in corporate governance, discusses the extent to which the concept of independence is undertheorized and insufficiently understood. Hill discusses complexities in information acquisition—how much more difficult the task is when, as is not uncommon, the information at issue is not known by either party and the subject matter does not lend itself to definitive and consensus expertise —and considers the extent to which decision-makers will create communities that craft norms as to acceptable information-acquisition procedures that community members can make use of (and potentially hide behind). Finally, Lipton provides a taxonomy of tactics available to regulators to influence corporate conduct.

CONCLUSION

Scholarship in law and economics continues and accretes. It increasingly integrates findings from behavioral law and economics and other fields. Advances in computing make new kinds of inquiries possible. This Symposium's aim is to expressly acknowledge the need for and recognize the extent to which practice can and should inform theory, just

9. *See generally* Claire A. Hill, *Why Contracts Are Written in "Legalese*,*"* 77 CHI.-KENT. L. REV. 59 (2001); Claire A. Hill, *Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts*, 34 DEL. J. CORP. L. 191 (2009).

10. Scott and Gulati have done particularly extensive work on the topic of boilerplate. *See, e.g.*, MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (2013).

as theory can and does inform practice, in scholarship, pedagogy, and even in the real world of business law.