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Paula M. Taffe

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IMPUTING THE WEALTH MAXIMIZATION PRINCIPLE TO STATE LEGISLATORS

Judge Richard A. Posner, of the United States Court of Appeals for the Seventh Circuit, is the most prominent and controversial figure in the field of law-and-economics. Law-and-economics is a body of thought that applies the principles of economics to the analysis of legal problems. As a scholar, Judge Posner's major contributions to the field have been his concept of efficiency as wealth maximization, his theory of the common law as a system of efficiency-promoting—or wealth-maximizing—legal rules, and his advocacy of wealth maximization as the appropriate criterion of social choice and judicial decision-making. His views have generated a host of commentary and criticism. Since his appointment to the bench in 1981, Judge Posner has had the opportunity to apply his theories in judicial opinions. Not surprisingly, this application has also begun to generate commentary.

In Judge Posner's view, economic analysis can be applied to a vast range of legal problems. In his book, Economic Analysis of Law, Judge Posner discussed the application of economics to virtually every substantive area of law. In addition, Judge Posner has used economic concepts to study the federal court system, to explain the concept of justice, to develop theories of procedure and to suggest an approach to constitut-

3. See R. POSNER, supra note 2.
4. See R. POSNER, supra note 2.
7. R. POSNER, supra note 2.
10. See R. POSNER, supra note 2, at 517; Posner, An Economic Approach to Legal Procedure and Judicial Administration, 2 J. LEGAL STUD. 399 (1973). See also Comment, supra note 6, at 1127.
tional and statutory interpretation. 11

This article will focus on Judge Posner's application of economic analysis to the interpretation of state statutes—an area that raises not only questions concerning the feasibility of using economics as a means of ascertaining legislative intent, but also questions concerning the judicial role and the very validity of using efficiency analysis to interpret statutes when, as Judge Posner recognizes, legislation is often based on goals other than economic efficiency. As will be seen, these questions take on additional significance in the context of federal diversity jurisdiction, where the role of a federal judge is to interpret state law as would the state's highest court. The article will demonstrate that by using economic analysis in interpreting state statutes, Judge Posner imputes to the legislature efficiency concerns that are not supported by the language of the statute, the available legislative history or, in one case, statements of the state supreme court. The article concludes that the use of economic analysis in statutory interpretation involves unacceptable speculation and, more importantly, is violative of the judicial role and potentially violative of federalism concerns.

Part I will briefly describe the principles of economic analysis of law and Judge Posner's scholarly views on statutory interpretation. Part II will outline three opinions written by Judge Posner involving the interpretation of state statutes and will discuss the economic considerations expressed or implied by the opinions. Part III will critically examine the approach taken in each case and will comment upon the legal and economic reasoning employed and the appropriateness of Judge Posner's approach.

I. JUDGE POSNER'S ECONOMIC VIEW 12

A. Wealth Maximization as a Concept of Efficiency

The foundation of Judge Posner's economic analysis of law is neoclassical price theory, or microeconomics, 13 which is the study of individual consumer and producer behavior and how that behavior determines price in a competitive market. 14 The theory proceeds from two basic

12. The elements of Judge Posner's economic analysis are clearly articulated in George Cohen's Comment, Posnerian Jurisprudence and Economic Analysis of Law: The View from the Bench, 133 U. Pa. L. Rev. 1117 (1985). This section of the article draws heavily from that work as well as from Judge Posner's writings.
13. See R. POSNER, supra note 2, at xx; Comment, supra note 12, at 1118.
14. Macroeconomics, on the other hand, is the study of the aggregate effects of supply and
assumptions: 1) that resources are scarce in relation to human wants; 15 and 2) that people act rationally to maximize their individual satisfactions or, in economic terms, their personal "utility." 16 From these two basic assumptions are derived two principles of economics: the law of supply and demand 17 and the concept of efficiency.

The concept of efficiency describes an economically desirable allocation of resources in society. While theorists have defined efficiency in various ways, 18 Judge Posner defines efficiency as that allocation of resources in which their value is highest so that the aggregate wealth of society is maximized. 19 He defines the value of a resource as the maximum amount one is willing and able to pay for it or the minimum amount one would accept to part with it. 20 A transaction is considered efficient if it results in shifting resources to higher-valued uses. 21

Because people are assumed to be rational self-interest maximizers, voluntary transactions are presumed to be efficient—i.e., voluntary trans-

demand on the economy as a whole and focuses on such problems as unemployment and inflation. See, e.g., W. PETERSON, PRINCIPLES OF ECONOMICS: MICRO 1 (4th ed. 1980) (distinguishing between "micro" and "macro" economics); Comment, supra note 12, at 1118 n.5.

15. See Comment, supra note 12, at 1119. Resources, in economic terms, are not limited to monetary or physical resources, but include intangible resources such as time. Id. at n.6.

16. The term "utility" can have several meanings. Consumers make choices to maximize utility, defined philosophically as happiness, pleasure and satisfactions, or defined economically as expected value or benefit. In the case of producers, one usually speaks of maximizing profits rather than utility. See R. POSNER, supra note 2, at 5, 11; Comment, supra note 12, at 1119.

17. The law of supply and demand expresses the relationships between price charged and quantity demanded and between price and output. A rational self-interested consumer faced with rising prices for particular goods will consider substituting other lower priced goods. Thus, the demand for the higher priced goods decreases. See R. POSNER, supra note 2, at 4-5. A rational profit-maximizing producer will expand output so long as the additional revenue gained by producing one more unit of output (called "marginal revenue") is greater than the additional costs incurred (called "marginal costs"). Id. at 249-51. A market is said to be in "equilibrium" when the conditions of supply and demand are such that there is no incentive for sellers to alter price or output. Id. at 8.

18. One definition is "Pareto efficiency." A Pareto efficient state is one in which there is a "socially optimal allocation" of resources. See Comment, supra note 12, at 1120. A "socially optimal allocation" of resources exists when no person can better his position without making someone else worse off. Id. Focusing upon individual transactions, a transaction is said to be Pareto superior if at least one person is made better off and no person is made worse off. R. POSNER, supra note 2, at 12.

Pareto efficiency is an austere concept. For example, a two person society in which one person had all the resources would be considered Pareto efficient since a change in resource allocation would make the advantaged person worse off. See Comment, supra note 12, at 1120.

Because transactions in the real world are rarely Pareto superior, a less austere concept of efficiency is provided by the Kaldor-Hicks model. See R. POSNER, supra note 2, at 12. Under this concept, sometimes called the "compensation criterion," an activity is considered efficient if the benefits to be gained outweigh the costs, so that the winners could potentially compensate the losers. See Comment, supra note 12, at 1124. Whether the winners do, in fact, compensate the losers does not affect the determination of whether the activity is efficient. R. POSNER, supra note 2, at 13.

19. R. POSNER, supra note 2, at 12.

20. Id. at 11.

21. Id. at 9.
actions will not occur unless both parties expect to maximize their interests. Thus, through the process of voluntary exchange, resources are shifted to higher-valued uses, and aggregate social wealth is maximized.

A major question in Judge Posner's efficiency analysis is whether and under what circumstances an involuntary exchange will be efficient. The concept of efficiency—under any theory—is based upon the ideal of voluntary exchange—i.e., a market. A "market failure" is said to occur where transaction costs, information costs or other obstacles to free trade make voluntary exchange infeasible. In such cases, the legal system may step in to correct a market failure. In determining whether a legal rule which effects or approves an involuntary transfer is efficient, Judge Posner applies a hypothetical-market analysis. The analysis asks whether, if voluntary exchange had been feasible, it would have occurred. A legal rule is considered efficient or efficiency-promoting if it effects or induces the same wealth maximizing allocation of resources as would the hypothetical market.

B. Wealth Maximization as a Principle of Justice

Judge Posner believes that, in large part, the law (particularly judge-made law) has been and should be guided by the goal of maximizing wealth. The first part of this belief—that the law has been guided by the principle of wealth maximization—is the major conclusion of Judge Posner's positive economic analysis of the common law. He views the

22. Id. at 13.
23. For example, assume A owns a book which he values at $5 (the minimum amount he would accept to part with it). B values the book at $10 (the maximum amount he is willing to pay for it). Since A and B are assumed to be rational self-interest maximizers, a sale of the book is likely to occur, provided that voluntary exchange—a market—is permitted. A sale at a price of, say, $7 will produce the following results: 1) the book has gravitated to a higher valued use (from $5 to $10) so that the wealth of society has increased by $5; 2) A has increased his wealth by $2 (received $7 for a book worth only $5 to him); and 3) B has increased his wealth by $3 (since he spent only $7 to acquire a book worth $10 to him). The sale was efficient because it maximized aggregate social wealth. In this example, it also increased each individual's wealth, but that is not part of Judge Posner's definition of efficiency, which focuses solely on aggregate social wealth.

Note that Judge Posner does not use the term "wealth" in an accounting sense. According to Judge Posner, wealth "is measured by what people would pay for things (or demand in exchange for giving up things they possess), not by what they do pay for them. Thus leisure has value, and is a part of wealth, even though it is not bought and sold." R. Posner, supra note 2, at 15.

24. See Comment, supra note 12, at 1120-21. Transaction costs include, among other things, the costs of finding trading partners, conducting negotiations, and obtaining information relevant to the transaction.

25. Judge Posner qualifies the idea of market failures, stating that the "failure is ordinarily a failure of the market and of the rules of the market prescribed by the common law." R. Posner, supra note 2, at 343 (emphasis in original).

27. For an example of Judge Posner's hypothetical-market analysis, see infra note 29.
28. Judge Posner has described positive economic analysis of law as "the use of economic anal-
common law as a coherent system of legal rules and doctrines which can best be explained as a system for maximizing wealth in society.29

The second part of Judge Posner's belief—that the law should be guided by a goal of maximizing wealth—is the normative side of economic analysis of law.30 This belief is primarily based upon two ideas: 1) that wealth maximization is an important value in society;31 and 2) that it is the only social value that courts can do much to promote.32

Concerning the first idea, Judge Posner has written that wealth "is conducive to happiness, freedom, self-expression, and other uncontroversial goods."33 As such, he notes that "conventional wisdom" holds that wealth is a value.34 However, the wealth that is valued by Judge Posner is aggregate social wealth rather than each individual's personal wealth. In Judge Posner's words, "[w]ealth maximization' as a guide to govern-
mental including judicial action means that the goal of such action is to bring about the allocation of resources that makes the economic pie as large as possible, irrespective of the relative size of the slices.”

Concerning the second idea—that wealth maximization is the only social value that courts can do much to promote—Judge Posner has written:

Courts can do very little to affect the distribution of wealth in a society, so it may be sensible for them to concentrate on what they can do, which is to establish rules that maximize the size of the economic pie, and let the problem of slicing it up be handled by the legislature with its much greater taxing and spending powers.

Proceeding from the view that wealth maximization should be the dominant principle of judicial decision-making, Judge Posner advocates the use of cost-benefit analysis to determine efficiency-promoting legal rules. In this area, Judge Posner builds upon the theories of Ronald Coase. Coase suggested that in a market where transactions are costless, individuals will achieve an efficient allocation of resources through private bargaining, regardless of the existing legal assignment of rights and liabilities. However, as Coase noted, where transaction costs are prohibitively high, individuals will be unable to rearrange rights established by law.

Judge Posner builds upon this idea by suggesting that courts should use cost-benefit analysis to assign rights and liabilities which reflect the allocation of resources that would result through private bargaining. Such an initial assignment of rights and liabilities accomplishes two

35. Posner, supra note 4, at 132.
36. Id. Judge Posner illustrates this idea with examples from landlord tenant law. He points to court enforcement of housing codes and unjust eviction laws as examples of how “the use of liability rules or other legal sanctions to redistribute income from wealthy to poor is likely to miscarry.” R. Posner, supra note 2, at 447. He argues that imposing liability on landlords merely results in increasing landlords’ costs, leading to higher rentals and hence to lowering the supply and raising the price of housing available to the poor. He suggests that public housing and rent subsidies—involving the taxing and spending power of the legislature—are economically more attractive ways of assisting the poor. He finds rent subsidies to be the most attractive method of assistance since it preserves a private market in housing. Id. at 445-48.
37. Posner, supra note 4, at 132.
39. Id. at 2-8. Coase illustrated this theory by the example of a confectioner operating a loud machine next door to a doctor who requires quiet. If the confectioner has the right to operate the machine, but the harm to the doctor is greater than the benefit to the confectioner, the doctor will likely pay the confectioner to stop using the machine—at a price greater than the benefit but less than the harm. An efficient allocation of resources results regardless of the initial assignment of the right to use the machine. For a full treatment of the example with its permutations, see id. at 8-10.
40. Id. at 19.
41. Judge Posner has stated that judges should use “cost-benefit analysis as the criterion of social choice, where the costs and benefits are measured by the prices that the economic market places on them, or would place on them if the market could be made to work.” Posner, supra note 4,
things: 1) it eliminates the transaction costs of private bargaining to circumvent an inefficient legal rule; and 2) it produces an efficient allocation of resources even where private bargaining is not feasible. In summary, the role of the court, in Judge Posner's view, is to promote efficiency by predicting and mimicking a market outcome.

C. Judge Posner's Approach to Statutory Interpretation

As we shall see, Judge Posner's approach to statutory interpretation is colored by his economic theory of legislation—an eclectic theory which incorporates the public interest and interest group theorists' views concerning the content of legislation. Judge Posner proposes categorizing laws along a continuum with the public interest and interest group categories at opposite ends. He designates the categories on the continuum as: 1) Public Interest, Economically Defined—limiting this category to legislation that corrects market failures; 2) Public Interest In Other Senses—a category for laws that promote a conception of the public interest other than efficiency, such as the just distribution of wealth; 3) Public Sentiment—including, for example, laws against pornography; and 4) Narrow-Interest-Group Legislation—a category of laws that promote the narrow self-interest of a particular group.

For Judge Posner, of course, the first category—public interest implicitly limited to maximization of aggregate social wealth—is preferable to the later categories, which increasingly depart from his economic ideal. The second category appears to represent the traditional lawyer's view of legislation. Judge Posner purports to see little tension between the first and second categories, since under both views legislation is designed to protect the public interest. He views the difference as merely definitional—a traditional lawyer would define "public interest" in equity at 132. See also Comment, supra note 12, at 1136-39 (discussing Judge Posner's application of cost-benefit analysis in several cases).

42. See R. Posner, supra note 2, at 42-45.
43. The public interest theory asserts that the function of legislation is to "increase economic welfare by correcting 'market failures' such as crime and pollution." R. Posner, supra note 8, at 262. The interest group theory, on the other hand, views legislation as a "commodity demanded and supplied much as are other commodities." Id. at 263. Through bargaining with legislators, interest groups induce the enactment of laws that redistribute wealth in their favor regardless of overall social welfare. Id.
44. Id. at 265-66.
45. Judge Posner states that "[t]he public interest and interest group theories are theories about the content of legislation, the former predicting that it will be efficient (always bearing in mind that efficiency may require some public redistribution of wealth), the latter that it will be amorally redistributive." Posner, Economics, Politics, and the Reading of Statutes and the Constitution, 49 U. Chi. L. Rev. 263, 268 (1982). He also states that "[f]rom a normative standpoint, therefore, the interest group theory is pessimistic concerning the purpose and effects of legislation, while the public interest theory is optimistic." Id. at 266.
or utilitarian terms while the economist defines "public interest" in terms of efficiency. However, Judge Posner considers the interest group legislation of the fourth category as "amorally redistributive" and "systematically perverse from a public interest standpoint."

While Judge Posner recognizes that a realistic view of legislation must incorporate both public interest and interest group statutes, and that judges are obliged to enforce statutes according to their intent, he is apparently uncomfortable at the prospect of judges (including himself) enforcing "amorally redistributive" and "systematically perverse" interest group statutes. He is willing to construe public interest statutes broadly to promote the public interest—implicitly defined as efficiency—while he finds that interest group statutes should be narrowly construed to honor the legislative bargain but avoid giving the interest group more than what the deal encompassed.

Moreover, Judge Posner points out that courts are not equipped to "conduct a social-scientific inquiry" into the legislators' motives or the interest group pressures to which they may have responded. He finds that traditional reliance on statutory language and legislative history can provide some guidance as to how broadly or narrowly a statute should be construed. But he strongly disagrees with resort to the traditional canons of construction, finding that they are based on "wholly unrealistic conceptions of the legislative process."

When the purpose or scope of legislation is uncertain, Judge Posner proposes a two-part approach as an alternative to the canons of construction. The first part, which he calls "imaginative reconstruction," requires the judge "to put himself in the shoes of the enacting legislators and figure out how they would have wanted the statute applied to the case before him." In so doing, the judge should consider not only the statutory language and legislative history, but also the values and atti-

46. See id. at 265-66.
47. Id. at 268; see also supra note 45.
48. Posner, supra note 45, at 266.
49. See R. POSNER, supra note 8, at 262-72.
50. See supra notes 45-46 and accompanying text.
51. See R. POSNER, supra note 8, at 267-86; Comment, supra note 12, at 1129.
52. R. POSNER, supra note 8, at 267.
53. Id. at 267-70.
54. Id. at 277. For example, Judge Posner finds that the canon that "remedial statutes are to be construed broadly" ignores the fact that often a statute is a compromise between groups of legislators. Id. at 278-79. For a compilation of the canons of construction, see J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION (C. Sands 4th ed. 1972).
55. R. POSNER, supra note 8, at 286.
56. Id. at 287.
57. Id. at 286-87.
tudes of the period in which the legislation was enacted.58

The second part comes into play if the attempt at "imaginative reconstruction" fails, perhaps for lack of necessary information.59 In that case, the judge must interpret the statute in a manner that yields the "most reasonable result."60 Judge Posner explains as follows:

[The judge] must decide the case, even though on the basis of considerations that cannot be laid at [the legislature's] door. These might be considerations of judicial administrability—what interpretation of the statute will provide greater predictability, require less judicial fact-finding, and otherwise reduce the cost and frequency of litigation under the statute? Or they might be considerations drawn from some broadly based conception of the public interest. It is always possible, of course, to refer these considerations back to [the legislature]. . . . [but] it is not healthy for a judge to conceal from himself that he is being creative.61

Judge Posner does not define "most reasonable result" or "public interest" as used in the above passage. However, given Judge Posner's ideology as reflected in his earlier discussion of the categories of legislation, it would not be surprising to find him interpreting "public interest" in terms of maximization of social wealth and engaging in efficiency analysis to determine the "most reasonable result." Indeed, as seen from the

58. Id. at 287. Judge Posner states, "[i]t would be a mistake to ascribe to legislators of the 1930s or the 1960s and early 1970s the skepticism regarding the size of government and the efficiency of regulation that is widespread today. . . . The judge's job is not to keep a statute up to date in the sense of making it reflect contemporary values, but to imagine as best he can how the legislators who enacted the statute would have wanted it applied to situations they did not foresee." Id.

In his most recent article on statutory interpretation, Judge Posner elaborates on his concept of imaginative reconstruction. He suggests that the position of a judge is much like the position of a soldier in battle who receives a garbled radio communication and yet must take some action. Comparing the judge to the soldier, Judge Posner states:

[In arguing that judges have a duty to interpret, even when the legislative intent is unclear, I am not arguing for judicial activism. The relationship between a military officer and his superiors and their doctrines, preferences, and values is, after all, the very model of obedience and deference. But the relationship does not entail inaction when orders are unclear. On the contrary, it requires "interpretation" of the most creative kind. And nothing less will discharge the judicial duty, even for those who believe, as I do, that self-restraint is, at least in our day, the proper judicial attitude. Creative and willful are not synonyms. You can be creative in imagining how someone else would have acted knowing what you know as well as what he knows. That is the creativity of the great statutory judge.]


60. R. Posner, supra note 8, at 287. Judge Posner cautions that the legislators' conception of reasonableness—not the judge's—must prevail. Id. However, he does not explain how the judge is to know the legislators' conception of reasonableness after the attempt to imaginatively reconstruct the legislative will has failed.

61. Id. at 289-90.
actual cases discussed below, Judge Posner does interpret statutes on the basis of efficiency analysis despite his earlier recognition that legislation often has nonefficiency goals.

II. Application of the Wealth Maximization Principle in State Statutory Interpretation

In *McMunn v. Hertz Equipment Rental Corp.*, Judge Posner examined an Indiana statute that invalidates certain indemnity agreements which shift liability for construction site accidents resulting from negligence or willful misconduct. *McMunn* had been injured at a construction site while operating a Bobcat loader which his contractor employer, Eichleay Corporation, had rented from Hertz for the performance of a construction contract with Inland Steel. *McMunn* sued Hertz for negligent failure to discover a defect in the loader. Hertz then impleaded Eichleay, pointing to a clause in the rental agreement in which Eichleay had promised to indemnify Hertz against liability for personal injuries arising from use of the loader. Eichleay defended on the ground that the clause was void under an Indiana statute which pro-

62. These three cases were chosen for several reasons. First, a survey of Judge Posner's opinions since his appointment to the bench revealed that interpretation of state statutes arises either in the context of a constitutional or preemption challenge to the statute or as the central issue in a diversity case or a pending state claim. The latter category, from which these three cases were drawn, provided discussions of state statutes presented at length and uncluttered by preemption or constitutional issues. Second, the cases were interesting because, as will be seen, they present three different types of application of efficiency analysis: 1) the first case presents an explicit, technical efficiency analysis; 2) the second case presents a theoretical application of the wealth maximization principle; and 3) the third case seems to be based on efficiency in terms of judicial administrability rather than substantive rights. Finally, the cases were interesting because, as discussed in Part III of this article, they pointed up several different types of objections to Judge Posner's approach.

63. *See supra* notes 36, 43-44, 49 and accompanying text.
64. 791 F.2d 88 (7th Cir. 1986).
65. The statute reads as follows:
Sec. 1. All provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction or design contract except those pertaining to highway contracts, which purport to indemnify the promisee against liability for:
(1) death or bodily injury to persons;
(2) injury to property;
(3) design defects; or
(4) any other loss, damage or expense arising under either (1), (2), or (3);
from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants or independent contractors who are directly responsible to the promisee, are against public policy and are void and unenforceable.

66. *McMunn*, 791 F.2d at 89.
67. The indemnification clause stated in pertinent part:
Customer [Eichleay] shall defend, indemnify and hold harmless lessor [Hertz], ... against all loss, liability and expense ... by reason of bodily injury ... sustained by any person ... as a result of the maintenance, ownership, use, operation, storage, erection, dismantling, servicing, or transportation of Equipment, whether such bodily injury ... [is] due or claimed to be due to any negligence of lessor [Hertz].
vides that "agreements contained in, collateral to, or affecting any construction or design contract except those pertaining to highway contracts, which purport to indemnify the promisee against liability for ... bodily injury ... [resulting] from the sole negligence or willful misconduct of the promisee" or his agents are void as against public policy.68

The district court held that the equipment lease agreement was not a contract which "affects construction"69 as envisioned by the statute, stating two reasons. First, the court noted that Hertz was not in control of the construction work nor did it retain control of the loader leased to Eichleay.70 Second, the court thought it would be "incongruous" to hold Hertz liable simply because Eichleay rented the loader for construction work when Hertz would not be liable if Eichleay rented equipment for a different purpose.71 Accordingly, the court granted Hertz's motion for summary judgment and Eichleay appealed.72

Writing for the court, Judge Posner affirmed the district court's decision, but for very different reasons. Judge Posner began by discussing the economic function of indemnity agreements. He described the agreement between Hertz and Eichleay as shifting liability to the party who could have prevented the accident at lower cost, noting "or so at least the parties may have thought when they signed the indemnity agreement."73 This statement is consistent with Judge Posner's basic economic principle that man is a rational self-interest maximizer—i.e., Hertz and Eichleay would not have made the agreement had it not maximized both parties' interests.

Judge Posner then stated that "[t]he rub is a statute which, if read literally, would make the agreement unenforceable."74 Noting that there was no legislative history or cases interpreting the statute in a similar setting, Judge Posner first focused on the meaning of the word "affecting." He concluded that this general term was probably used by the legislature in order to plug a potential loophole that would allow parties to a

68. See supra note 65.
69. McMunn, No. H81-414, at 5. The district court rejected Eichleay's argument that the rental agreement "affected a construction contract" and instead concluded that the rental agreement was not a "contract which 'affects construction.' " Id.
70. Id.
71. Id.
72. Id. at 7. The trial court certified the order for immediate appeal under Rule 54(b) of the FED. R. CIV. P. McMunn, 791 F.2d at 90.
73. 791 F.2d at 91.
74. Id.
construction contract to evade the statute by simply making a separate indemnity agreement. He noted that the use of general language in order to plug a loophole invites overly broad interpretation. He found that the term “affecting” was far too general, since “[i]n an interrelated economy almost everything affects everything else.”

Finding little help from the language of the statute, Judge Posner then turned to its purpose. An Indiana Court of Appeals case had suggested that the statute may have been intended to protect subcontractors from broad hold-harmless clauses indemnifying general contractors or to protect construction workers and the general public by increasing safety at construction sites. Judge Posner expressed doubt that the law would contribute to construction site safety. He acknowledged the possibility that if a general contractor can shift the financial burden of liability he might become more careless. However, he pointed out, there is a disincentive to such carelessness: the indemnitee will have to compensate the indemnitor for imposing a greater risk of liability on the indemnitor just as a person who has liability insurance may have to pay a higher premium for his greater carelessness. He conceded that “the buffering of liability” by the indemnity agreement might result in some additional carelessness, but he claimed that “this would not matter” if the victims of such extra carelessness received full compensation ex post through damage awards or ex ante through higher wages. Nevertheless, he

75. Id. at 92. Judge Posner stated that “[s]tatutes are drafted in haste and sometimes carelessly, by busy legislators concerned with a particular problem but also concerned not to draft their statute so narrowly that it opens gaping loopholes.” Id. at 93.
76. Id. at 92.
77. Id. To illustrate, Judge Posner noted that “[a]n indemnity agreement between the manufacturer of spark plugs used in a General Motors truck and General Motors could affect a construction contract in the performance of which the truck was used.” Id.
79. 791 F.2d at 92.
80. Id. It should be noted that Judge Posner’s comparison of the indemnity agreement to a standard liability insurance contract is questionable. A person insured by an insurance company maintains a continuing relationship with the insurer and thus can expect to pay higher premiums in the future as a result of his present carelessness. This safety incentive does not exist in the situation of an indemnity contract between parties who have no expectation of a continuing relationship.
81. Id. Judge Posner overlooked the fact that “full compensation” for loss of life or limb or other physical injuries is not possible in practice. Moreover, full compensation of the victim would not change the fact that the indemnity agreement, once entered into, removes the incentive of the indemnitee to behave carefully. See supra note 80. Nor is it true, as Judge Posner stated, that the indemnitee and indemnitor are both better off (“otherwise they would not have made the contract,” 791 F.2d at 92). In fact, the indemnitee may behave more carelessly than the indemnitor thought he would, so that the agreement to indemnify was underpriced in relation to the actual risk transferred.
concluded,

[T]he compensation may not be adequate, because of lack of information or other frictions. So, in sum, it is possible to understand how the Indiana legislature might have believed that banning indemnity agreements might make construction workers safer; whether its belief was correct or not is none of our business.\textsuperscript{82}

That discussion demonstrates that Judge Posner implicitly assumed that the legislature was concerned only with “efficient safety” rather than with safety beyond an economically optimal level. The discussion focuses on the optimal level of safety that would be chosen by the indemnitee if he were to take into account all the expected damages resulting from his negligent or willful activity and assumes that these expected damages will be reflected in the price the indemnitee pays for the indemnity agreement. Judge Posner admits that indemnity contracts might not always induce an optimal level of safety “because of lack of information or other frictions”\textsuperscript{83} and that the Indiana legislature might therefore “have believed that banning indemnity agreements might make construction workers [optimally] safer.”\textsuperscript{84}

Judge Posner then stated, “[i]f this is the policy behind the statute, it would be but weakly engaged by applying the statute to the present case.”\textsuperscript{85} He noted that the Bobcat loader is used not only for nonhighway construction, as in this case, where indemnity agreements are not allowed, but also for highway construction and nonconstruction uses altogether, where indemnity agreements are allowed. Not knowing the percentage of loaders leased by Hertz for nonhighway construction, he “suppose[d] it is small.”\textsuperscript{86} As such, he found that invalidating Hertz’s indemnity agreements would have a negligible effect on Hertz’s safety incentives since Hertz would “not make appreciably more careful inspections on the off chance that the loader might be put to a use for which it would not have indemnity.”\textsuperscript{87} He noted, however, that where equipment is “specialized to nonhighway construction” the supplier’s safety incentives might be enhanced by forbidding indemnity contracts.\textsuperscript{88} Accordingly, Judge Posner held that “the supplier of a nonspecialized good who has no (other) basis for thinking that the good will be used in construction is not within the scope of the statute.”\textsuperscript{89} In effect, Judge Posner

\textsuperscript{82} 791 F.2d at 93.
\textsuperscript{83} See supra text accompanying note 82.
\textsuperscript{84} \textit{Id}.
\textsuperscript{85} 791 F.2d at 93.
\textsuperscript{86} \textit{Id}.
\textsuperscript{87} \textit{Id}.
\textsuperscript{88} \textit{Id}.
\textsuperscript{89} \textit{Id}.
engrafted a scienter requirement onto the statute—requiring either actual knowledge or reason to know by virtue of the good being “specialized to nonhighway construction.”

As this discussion demonstrates, Judge Posner assumed that the expected liability in this case was so negligible that it would not be considered by the parties in pricing the safety costs and would thereby have no effect on optimal safety. Thus, even if the indemnity agreement were invalidated by the statute, Hertz would have no incentive to make “appreciably more careful inspections.”

Judge Posner's reading of the statute can be explained from either a public interest or interest group perspective. If he considered the statute to be public interest legislation, he implicitly defined the public interest as efficient safety and concluded that application of the statute would not promote that goal. On the other hand, if Judge Posner considered the statute to be interest group legislation—perhaps intended to protect construction workers by reducing the number of accidents or to protect subcontractors from being forced into the role of insurer—he gave the statute a narrow reading consistent with his approach to interest group statutes.

McMunn presented an explicit and technical application of efficiency analysis to interpret a state statute. In Remus v. Amoco Oil Co., Judge Posner implicitly applied the wealth maximization principle on a more theoretical level. Remus involved a Wisconsin statute which governs certain franchisor-franchisee relationships. Amoco, the franchisor, had instituted a change in its credit card operations in order to separate or “unbundle” its cash and credit card sales. Prior to the change, the cost of Amoco's credit card system was reflected in the wholesale gasoline price charged to dealers. The dealers then sold the gasoline at a uniform retail price to all customers, cash and credit alike. Amoco stated that, in effect, cash customers were subsidizing credit card customers by paying a higher price than they would pay if credit card costs were not included in the price. As a result, dealers in other brands of gasoline were able to attract cash customers away from Amoco dealers by offering a discount on cash purchases.

Amoco described the change as involving two components: 1) a re-

90. Id.
91. 794 F.2d 1238 (7th Cir.), cert. dismissed, 107 S. Ct. 333 (1986).
93. 794 F.2d at 1239.
95. 794 F.2d at 1239.
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duction in the wholesale price charged to dealers, with the intention that dealers would pass on the discount to cash customers; and 2) the imposition on dealers of a fee for credit card sales, with the intention that the dealers would pass on the fee to credit card customers. Remus, an Amoco dealer, brought an action against Amoco alleging that Amoco's purported discount on the wholesale gasoline price was an illusion because Amoco unilaterally controls the wholesale price. Class certification was requested. The dealers claimed that, in fact, they received no discount and, instead, were simply charged for credit card sales so that Amoco's revenues would increase at the dealers' expense. They further contended that the attempt to pass on the credit card fee resulted in erosion of their customer base so that they suffered financial losses. The dealers alleged that Amoco's action violated the Wisconsin Fair Dealership Law ("WFDL").

The WFDL forbids a franchisor to "terminate, cancel, fail to renew or substantially change the competitive circumstances of a dealership agreement without good cause." A franchisor, acting upon good cause, must give the dealer at least 90 days notice of the intended action and give the dealer 60 days "to rectify any claimed deficiency." Remus maintained that Amoco's imposition of a fee for credit card sales substantially changed the competitive circumstances of his dealership agreement without 90 days notice and without good cause.

The district court granted Amoco's motion for summary judgment. The court reasoned that although Amoco's action had "without a doubt, changed the competitive circumstances of Remus' dealership," Amoco had instituted the change for sound business reasons. The court concluded that the "good cause" provision of the WFDL encompassed business reasons unrelated to the dealer.

Judge Posner, writing for the court, affirmed the district court decision, again under a different line of reasoning. He first stated, "we must try to answer [the questions raised] as best we can from the words of the statute—for there is no pertinent legislative history, no similarly worded

96. Compare Brief of Defendant-Appellee at 5 with 794 F.2d at 1239 (adopting Amoco's description of the "unbundling" of cash and credit card sales).
97. See Brief of Plaintiffs-Appellants at 7-9.
98. Id. at 17-19.
99. Id. at 17-18.
100. Wis. STAT. §§ 135.01-.07 (1983-84).
101. Id. § 135.03.
102. Id. § 135.04.
103. 794 F.2d at 1240.
105. Id.
statute in another state, and no decision by a Wisconsin court interpreting the statute in any respect pertinent to this case."106 He then described at length—and with apparent approval—the motive behind and effect of Amoco's action. He stated that "[t]he idea behind the unbundling was not to change Amoco's revenues (in the short run) but merely to shift the entire cost of the credit card program onto the shoulders of the credit card customers."107 He further stated:

If, as Amoco hoped, the dealer gained more cash customers from the discount for cash than he lost credit card customers by the surcharge for credit, both Amoco and the dealer would be better off. Of course a dealer who for one reason or another was much better at attracting credit card customers than cash customers might end up worse off.108

These statements demonstrate Judge Posner's focus on aggregate social wealth. He adopted Amoco's statement of the facts109 and implicitly viewed Amoco's action as wealth maximizing because it would benefit both parties in the aggregate. He was not concerned with those dealers who would be hurt by the change.

Judge Posner then turned to the statute. He found that the statute's definition of "good cause"110 combined with the cure provision—which gives the dealers 60 days to rectify any claimed deficiency111—clearly indicated that "good cause" is confined to fault by the dealer.112 Since Amoco's change was made purely for business reasons rather than dealer deficiency, the issue became whether Amoco's action constituted a "substantial change in competitive circumstances." He concluded that it did not.

He first found that the phrase "substantial change in competitive circumstances" might have been intended to encompass actions by the franchisor that would constitute constructive termination of a dealership.113 He then suggested that the statute might go so far as to forbid actions which adversely affect competition, such as granting too many

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106. 794 F.2d at 1238.
107. Id. at 1239.
108. Id.
109. See supra note 96 and accompanying text.
110. The statute defines "good cause" to mean either "[f]ailure by a dealer to comply substantially with essential and reasonable requirements imposed upon him by the grantor... which requirements are not discriminatory as compared with requirements imposed on other similarly situated dealers" or "[b]ad faith by the dealer in carrying out the terms of the dealership." Wis. STAT. § 135.02(4).
111. See supra note 102 and accompanying text.
112. 794 F.2d at 1240.
113. Judge Posner described constructive termination as "the franchisor's making the dealer's competitive circumstances so desperate that the dealer 'voluntarily' gives up the franchise." Id. at 1240.
dealerships in one locality. However, he “hesitate[d] to conclude” that the legislature intended the statute to require a franchisor to obtain unanimous dealer consent to institute a system-wide nondiscriminatory change that would benefit the franchisees as a whole.  

He stated that such a law would transform the franchisor-franchisee relationship “much as a law which” provided that “a company could not alter its prices or products without” unanimous employee consent. He found that such a law would allow a “handful of dissenters” to “use the class action device” to block a change that would benefit the majority of franchisees.

These statements provide further evidence of Judge Posner’s focus on aggregate social wealth. He concluded that the legislature could not have intended the statute to block an overall wealth maximizing change in Amoco’s business, regardless of whether certain dealers might in fact have been injured. As such, Amoco’s action was not barred by the statute.

As in McMunn, Judge Posner’s interpretation of the statute can be explained from either a public interest or interest group perspective. From a public interest standpoint, Judge Posner might view the statute as prohibiting non-voluntary, non-negotiated changes in order to promote efficiency. Under this viewpoint, however, it would be inefficient—and perhaps infeasible because of the transaction costs—to extend the law so far as to require Amoco to negotiate individual agreements to institute a system-wide, wealth maximizing change. From an interest group standpoint, Judge Posner would view the statute as protecting the interests of the dealers regardless of overall social wealth. Under this viewpoint, he construed the statute narrowly, considering the legislative deal to encompass no more than protection against actual or constructive termination.

Judge Posner also addressed the franchisor-franchisee relationship in My Pie International, Inc. v. Debould, Inc. The dispute in My Pie involved the application of several provisions of the Illinois Franchise Disclosure Act (“IFDA”). First, under the IFDA, a franchisor must file a disclosure statement with the Illinois Attorney General and provide prospective franchisees with a copy of the statement not less than seven days before either execution of a franchise agreement or payment by the

114. Id. at 1241.
115. Id.
116. Id.
117. 687 F.2d 919 (7th Cir. 1982).
franchisee of "any consideration." Second, upon application the Attorney General may grant an exemption from these disclosure requirements. Third, a sale of a franchise in violation of the Act is voidable at the election of the franchisee provided that he notifies the franchisor within 90 days of learning of the violation. Finally, the right to maintain an action for violation of the IFDA expires one year after the discovery of the fact constituting the violation and three years after the act or transaction constituting the violation.

In *My Pie*, two individuals, Germain and Beadle, formed Dowmont, Inc. in order to purchase a My Pie pizza franchise. Since My Pie had not yet registered under the Act, Dowmont and My Pie requested and received an exemption. The Attorney General's order identified the exempted transaction simply as the purchase of a franchise in "Westmont," Illinois. No street address was stated, and the town name, Westmont, was misspelled. The parties executed the franchise agreement in May, 1975, reciting in the agreement an address in Westmont. Shortly thereafter, Dowmont lost its lease at the Westmont address and found another site in the nearby suburb of Glen Ellyn, Illinois. The parties then altered the agreement by lining out the Westmont address and substituting the Glen Ellyn address.

In October, 1977, Germain and Beadle opened a second My Pie restaurant under a second corporation, Debould, Inc. My Pie, having by this time registered under the Act, gave Germain a disclosure statement. The cover page stated in bold type the IFDA requirements. Before receiving the statement, Debould had purchased some supplies from My Pie, including menus and T-shirts. After Debould received the statement, the parties executed the Debould franchise agreement.

In 1979, Dowmont and Debould ceased making royalty payments.

119. *Id.* §§ 704, 716. The required content of the disclosure statement is detailed in § 705. The Attorney General is identified as the administrator of the Act in § 703(20).
120. *Id.* § 712.
121. *Id.* § 721(2)(a)-(b).
122. *Id.* § 722.
123. See 687 F.2d at 926-27 (Eschbach, J., concurring in part and dissenting in part). Judge Posner recited very few facts in his opinion. Therefore, this article relies for the most part on the statement of facts in the dissenting opinion. Of necessity, page number citations skip back and forth between the majority and the dissent.
124. *Id.* at 923.
125. *Id.* at 927.
126. *Id.* at 928.
127. See *id.* at 928, 933.
128. *Id.* at 929.
129. *Id.* at 922.
130. *Id.* at 929.
In 1980, both corporations sent notices of rescission to My Pie, claiming violations of the IFDA.\textsuperscript{131} My Pie brought suit for recovery of royalties under the franchise agreements. Debould and Dowmont counterclaimed for royalties already paid under the agreements.\textsuperscript{132} At trial, Germain claimed that the notices of rescission were timely because he did not learn of the violations until a conference with his attorney in January, 1980.\textsuperscript{133} The district court awarded royalties to My Pie under the franchise agreements and denied the counterclaims.\textsuperscript{134}

Writing for the majority, Judge Posner reversed the award of royalties to My Pie and reinstated Debould's counterclaim.\textsuperscript{135} He found that My Pie had violated the IFDA with respect to both corporations. He viewed Dowmont's Westmont and Glen Ellyn sites as two separate franchises and found that the Attorney General's exemption order did not apply to the Glen Ellyn franchise.\textsuperscript{136} He viewed Debould's payments for menus and T-shirts as "consideration" under the Act\textsuperscript{137} and thus found that, although My Pie had provided a disclosure statement to Debould more than seven days before executing the franchise agreement, it had failed to provide the statement more than seven days before it received the consideration for menus and T-shirts.\textsuperscript{138}

Having found violations with respect to both franchises, Judge Posner then considered the issues of rescission and estoppel. As to the ninety day limitation period for notice of election to rescind, he noted that franchisees may acquire first knowledge of a violation from their attorneys.\textsuperscript{139} He then simply stated that My Pie had failed to prove that the defend-

\textsuperscript{131} Id. \\
\textsuperscript{132} Id. at 921. \\
\textsuperscript{133} Id. at 923, 935. \\
\textsuperscript{134} Id. at 921. \\
\textsuperscript{135} Id. at 926. Dowmont had not appealed the denial of its counterclaim. \\
\textsuperscript{136} Id. at 923. Judge Posner did not elaborate. He simply stated that the Attorney General's order was limited to the sale of a franchise in Westmont and that the "Westmont project [fell] through." Id. \\
\textsuperscript{137} Id. at 922. He based his belief, in part, upon the care with which the statute's draftsmen had defined "franchise fee." He concluded that had the draftsmen intended to confine "consideration" to mean payment of the franchise fee, they would have so stated. Id. at 922-23. Judge Posner also stressed the fact that the IFDA was intended to protect uninformed franchisees—an objective that would be undermined "if the franchisor could collect income in this form from its franchisees indefinitely, without complying with the statutory disclosure requirement." Id. at 923. \\
\textsuperscript{138} Id. at 922. \\
\textsuperscript{139} Id. at 923. Judge Posner relied upon Brenkman v. Belmont Mktg., Inc., 87 Ill. App. 3d 1060, 1065, 410 N.E.2d 500, 504 (1980). In Brenkman, the parties had executed a "Management Agreement" on August 9, 1978. The plaintiff (franchisee) was assured by the defendants that the agreement was not governed by the IFDA. In November, 1978, plaintiff's attorney advised him that the agreement was a franchise agreement and that he would be protected by the IFDA. On December 21, 1978 plaintiff rescinded the agreement. The court held that the notice to rescind was timely since the plaintiff first learned of the violation from his attorney in November, 1978.
nants had earlier knowledge.140 In response to the contention that Dowmont was estopped from asserting a violation of the IFDA, Judge Posner first expressed his view that estoppel should not be an available defense under the statute.141 He then found that, in any event, My Pie was not justified in relying upon Dowmont's exemption application because he read the exemption order as permitting My Pie only to delay giving Dowmont the disclosure statement until December 31, 1975, the expiration date of the order. He stated that My Pie was not justified in believing that Dowmont would "wait forever" to receive the statement.142

Finally, Judge Posner turned to Debould's counterclaim and found that, although the counterclaim, filed in April, 1981, was clearly barred by the IFDA limitation periods, it was not barred under a different Illinois statute of limitations. This general statute permits a defendant to plead a time-barred counterclaim so long as the plaintiff's cause of action was "owned" by the plaintiff before the defendant's claim became time-barred.143 Judge Posner stated that since My Pie "owned" its cause of action before it brought suit on August 18, 1980, Debould's counterclaim was not barred.144

Judge Eschbach wrote an elaborate dissent which will be briefly summarized here. Judge Eschbach concluded that My Pie had not violated the IFDA. With respect to the Dowmont franchise, Judge Eschbach found that Dowmont purchased a single franchise—a license to operate one My Pie restaurant—and that the parties lawfully executed the franchise agreement while the exemption order was in effect.145 Contrary to Judge Posner's finding that the exemption did not apply to the

140. 687 F.2d at 923.
141. Judge Posner relied upon caselaw from North Dakota and Minnesota. Peck of Chehalis v. C.K. of W. Am., Inc., 304 N.W.2d 91, 98-100 (N.D. 1981); Country Kitchen of Mount Vernon, Inc. v. Country Kitchen of W. Am., Inc., 293 N.W.2d 118 (N.D. 1980); Chase Manhattan Bank, N.A. v. Clusiau Sales & Rental, Inc., 308 N.W.2d 490, 494 (Minn. 1981). The Peck court held that estoppel is a defense under the North Dakota franchise disclosure statute. Judge Posner distinguished the North Dakota statute from the IFDA by noting that the North Dakota statute authorizes an action for rescission without using the word "voidable" while the IFDA authorizes an action for rescission using the words "voidable at the election of the franchisee." See My Pie, 687 F.2d at 924; see also infra note 148 and accompanying text. The Country Kitchen and Chase Manhattan Bank courts did not address the issue of estoppel.
142. Id. at 925.
143. The statute provides in pertinent part:

§ 13-207. Counterclaim or set-off. A defendant may plead a set-off or counterclaim barred by the statute of limitation, while held and owned by him or her, to any action, the cause of which was owned by the plaintiff or person under whom he or she claims, before such set-off or counterclaim was so barred, and not otherwise.

ILL. REV. STAT. ch. 83, § 17 (1981)(now ch. 110, § 13-207 (1983)).
144. 687 F.2d at 925. Judge Posner did not elaborate.
145. 687 F.2d at 931 (Eschbach, J., dissenting).
"Glen Ellyn franchise," Judge Eschbach pointed out that the order referred to "Westment" (misspelled) simply for the purpose of general identification of the transaction—not for identification of a specific location. He noted that under Judge Posner's reasoning, if Dowmont had found a different location in Westmont (or perhaps "Westment") the exemption order presumably would have been effective. With respect to the Debould franchise, Judge Eschbach disagreed that the payment of two invoices for menus and T-shirts was "consideration" under the IFDA. Noting that anyone can buy My Pie T-shirts, he reasoned that the disclosure statement is designed to protect prospective franchisees before they contractually commit themselves to a franchise agreement by making an advance payment for the franchise—not to protect prospective T-shirt purchasers.

Even if the change of address for the Dowmont franchise could be construed as a violation, Judge Eschbach strongly disagreed with Judge Posner's view that estoppel is not a defense under the IFDA. He found that My Pie was justified in believing it would never have to provide a disclosure statement and that Dowmont was estopped from asserting a "hypertechnical violation." He contended that Judge Posner's reading of the exemption order as merely delaying the time for disclosure represented a "basic misunderstanding of the purpose of the disclosure statement." Noting that the purpose of the IFDA is to protect prospective franchisees, he found that Judge Posner's interpretation made little sense, since once the franchise agreement is executed there is no longer a prospective franchisee to be protected.

The next issue was whether the franchisees gave timely notice of their election to rescind. Judge Eschbach characterized Germain's claim of ignorance as "self-serving," and pointed out that Beadle testified that at the time of the exemption request Germain had informed him that the exemption was required due to the disclosure requirement of the IFDA. Judge Eschbach found that "there is no question that

146. Id. at 932.
147. Id. at 936.
148. Id. at 933-34. Judge Eschbach stated, "[t]he distinction which the majority points to in support of its uncertainty on this question—a purported distinction between authorizing an action for rescission and making a contract voidable—escapes me. Under Illinois law, and the common law for that matter, a voidable contract is voided through rescission." Id. at 933. See supra note 141 and accompanying text.
149. 687 F.2d at 934.
150. Id.
151. Id. at 932.
152. Id. at 935.
153. Id. at 927.
Germain (not to mention Beadle, whom the majority fail[ed] to mention) knew the legal rule, and knew he had not received a timely disclosure statement, at least as early as 1977, and probably as early as 1975. Since the district court had not addressed the credibility of Germain's claim, he contended that at the very least the case should have been remanded for factual findings on this issue.

The final issue was whether Debould's counterclaim was time-barred. Initially, Judge Eschbach argued that the general statute of limitations could not be used to supplant a fixed limitation expressed in the statute that creates the action. However, he found that even if application of the general statute was appropriate, Judge Posner misapplied it. He explained that under the IFDA, Debould's action expired one year after it learned of the fact constituting the violation. According to Judge Eschbach, Debould knew that it had not received a disclosure statement at the time it paid the invoices for menus and T-shirts in October, 1977. Therefore, the counterclaim was barred in October, 1978. My Pie's action for breach of the franchise agreement did not accrue until March, 1979 when Debould defaulted on its royalty payments. Thus, Debould did not “own” its counterclaim within the period of time that My Pie “owned” its cause of action.

Judge Posner's opinion in *My Pie* would seem to be difficult to reconcile with his economic principles. If the statute is viewed in light of Judge Posner's second category of legislation—Public Interest In Other Senses—as requiring reasonable disclosure, there seems to have been reasonable disclosure. My Pie apparently acted in good faith, and there were no allegations of fraud. If the statute is viewed as interest group legislation, Judge Posner clearly did not interpret the statute narrowly, but quite broadly to protect the franchisees. And if the statute is viewed in light of Judge Posner's first category of efficiency-promoting laws, the decision also seems puzzling. Judge Posner has written, “[e]conomic analysis reveals no grounds other than fraud, incapacity, and duress . . . for allowing a party to repudiate the bargain that he made in entering into [a] contract.” Yet, in *My Pie*, he seemed to jump through hoops to allow Dowmont and Debould to rescind their franchise

154. *Id.* at 935.
155. *Id.*
156. *Id.* at 936-37.
157. *See supra* note 122 and accompanying text.
158. 687 F.2d at 937-38.
159. *See supra* text accompanying note 44.
agreements, years after they were made, on the basis of purely technical violations of the IFDA.

Upon closer examination, however, it is suggested that Judge Posner's puzzling resolution may, indeed, be explained in terms of economic considerations. Recall the earlier discussion of Judge Posner's two rationales to be considered in reaching the "most reasonable result": considerations of the public interest and considerations of judicial administrability.161 Focusing upon considerations of the public interest defined in terms of efficiency, Judge Posner would not ordinarily be in favor of information at any cost. For example, in discussing fraud, he has written that "[t]he question of liability for nondisclosure should turn on which of the parties to the transaction, seller or consumer, can produce or obtain information at lower cost."162 And, in fact, he finds many disclosure and information-related laws to be inefficient.163 In My Pie, however, Judge Posner's hands were tied in terms of being able to interpret the statute to affect the disclosure requirements. My Pie did not present substantive interpretation questions;164 the statute clearly applied. Rather, the case turned upon fact questions and equity principles.

Since the statute clearly requires disclosure, it would seem that Judge Posner turned instead to considerations of judicial administrability—i.e., what is the most efficient way to enforce the disclosure requirement. In discussing the "most reasonable result" portion of his approach to interpretation, Judge Posner has written, "[w]hat if, for example[,] the statute would be much cheaper to administer if it were interpreted as embracing the claim made by this party? I consider this a proper reason for 'interpreting' the legislation to cover the claim."165 In My Pie, a rule that took in all equitable considerations and allowed the parties some flexibility—such as lining out an address or collecting payment for menus and T-shirts—would create more litigation and judicial factfinding and thus would be more costly to administer. From an efficiency standpoint, it is cheaper to administer a strict rule that will reduce litigation.166 Moreover, compliance with a strict rule will not be signifi-

161. See supra text accompanying notes 59-61.
162. R. POSNER, supra note 2, at 99.
163. See id. at 346-50 (discussing the Federal Trade Commission disclosure requirements), 420-
24 (discussing securities regulations), 392-93 (discussing insider trading).
164. The court did, however, interpret the word "consideration." See supra note 137 and ac-
companying text.
165. R. POSNER, supra note 8, at 290.
166. One might suggest that if franchisees are permitted to rescind a contract on the basis of technicalities, the result would be more litigation. The response is that presumably franchisors will be aware of and guard against the potential exposure so that the net result is decreased litigation.
cantly more costly ahead of time for future franchisors once they know such compliance is required.

Focusing upon judicial administrability, the strict rule in *My Pie* can also be reconciled with Judge Posner's categories of legislation. On the one hand, a strict rule does not offend the efficiency concept of the public interest. As mentioned above, since the statute already requires disclosure, strict compliance will not impose significantly greater costs upon the franchisor. On the other hand, in this case there would seem to be no harm in giving a broad reading to an interest group statute. The franchisees are already entitled to disclosure; assuming that future franchisors heed the strict rule, franchisees will receive no greater benefit than that to which they are already entitled.

### III. Objections to Judge Posner's Approach

The previous section outlined both Judge Posner's opinions and the economic factors expressed in or suggested by the decisions. This section will present two major criticisms and several associated objections to Judge Posner's approach. The first major criticism is that the use of efficiency analysis as the basis for interpreting statutes violates the judicial role by usurping the legislative function. As Judge Posner himself admits, the legislature often has goals other than economic efficiency in mind and the judge's role is to apply the statute in accordance with the legislature's goals. A corollary to this criticism is that Judge Posner's approach is also potentially violative of federalism concerns, since the role of a federal judge is to apply state law as would the state's highest court. Thus, in the context of federal diversity jurisdiction, Judge Posner's approach imputes efficiency concerns not only to the state legislature but also to the state judiciary.

The second major criticism is that efficiency analysis itself provides a flawed basis for decision-making. First, the analysis requires data that is simply not available to judges, and thus the efficiency approach is necessarily speculative and capable of great manipulation. Second, because the analysis is complex and depends on numerous variables that are often speculatively supplied, it is easily misapplied, even by a master such as Judge Posner himself. Finally, the complexity of efficiency analysis, especially when it is misapplied or provides a hidden basis for arguments that are not clearly articulated, makes the rationale for his opinions incomprehensible to nonexpert judges, practitioners and students. Thus, his approach fails to provide certainty and guidance in law-making.

167. *See supra* notes 36, 43-44, 49 and accompanying text.
The three cases discussed in Part II of this article point up several particular objections associated with the two major criticisms presented above. These are Judge Posner's use of unsupported assumptions, his treatment of statutes as if he were writing on a blank slate, and his focus on efficient rule formulation in disregard of equitable considerations. While these objections apply—to a greater or lesser degree—to each of the opinions, each case will be analyzed in light of the objection that is most graphically illustrated.

A. The Assumption Approach

As discussed in Part I of this article, Judge Posner calls the first part of his approach to statutory interpretation "imaginative reconstruction."

He further admits that the approach is "easy to ridicule" by saying that a judge does not have the requisite imagination and will simply assume the legislators thought like himself. Judge Posner counters this potential criticism by noting that a conscientious judge will be alert to the language, purpose, background, structure and legislative history of the statute, as well as the values and attitudes of the period in which the legislation was enacted.

In *McMunn*, Judge Posner made a series of assumptions through "imaginative interpretation" to determine that Hertz's indemnity agreement was not one "affecting" a construction contract as contemplated by the statute. The first assumption was that the use of the general term "affecting" must have been the result of busy and careless legislators attempting to plug a loophole that would allow parties to a construction contract to evade the statute by making a separate indemnity contract. However, the legislators seem to have covered that loophole by use of the term "collateral." Perhaps the legislators used the words "contained in, collateral to or affecting" in order to create three classes of agreements: 1) those contained in the construction contract; 2) separate agreements made between the original parties to the construction contract; and 3) agreements involving an original party and

168. See supra text accompanying notes 55-58.
169. Posner, supra note 59, at 817; see also R. Posner, supra note 8, at 287.
170. 791 F.2d 88 (7th Cir. 1986). This case is discussed supra text accompanying notes 64-90.
171. 791 F.2d at 93. Judge Posner stated, "it is the task of courts by imaginative interpretation to keep the statute within reasonable bounds, as we have tried to do." Id.
172. For analytical purposes, the assumptions are presented in a slightly different sequence than in both the written opinion and Part II of this article.
173. See supra note 75 and accompanying text.
174. In the law of contracts, the term "collateral" is commonly used to denote a separate agreement made between the parties to a contract. See, e.g., 4 S. Williston, A TREATISE ON THE LAW OF CONTRACTS § 638 (3d ed. 1961) (discussion of the parol evidence rule).
some third party that directly affect the performance of the construction contract. By simply assuming that the term "affecting" was surplusage, Judge Posner side-stepped the major interpretive question in the case—i.e., what classes of cases did the legislators intend the statute to govern? Instead, the assumption cleared the way for employing efficiency analysis to decide the case.

The second assumption was that the legislature's purpose was only efficient safety rather than some higher level of safety. This assumption stems solely from Judge Posner's economic predisposition rather than from any available indicia of the legislature's intent.

The third assumption was that the indemnity agreement shifted liability to the party who could have prevented the accident at lower cost. There is nothing in the facts to indicate that this was the case. The loader was allegedly defective. The rental agreement indicated that Hertz was to deliver the loader to the construction site on the day before the accident. The facts do not indicate whether—and, if so, at what cost—Eichleay would have been able to discover the defect. One might assume that Hertz, in the course of regular inspections of its equipment, could discover potential defects at lower cost than Eichleay, who apparently merely accepted delivery of the loader and would not, in the ordinary course of business, have mechanics on hand to make inspections. Moreover, the rental agreement was a printed form contract and the parties stipulated that Hertz did not know the intended use of the loader. These facts indicate that the parties had not deliberated over who could prevent the accident at a lower cost.

Judge Posner next assumed that the percentage of loaders leased by Hertz for nonhighway construction use was small. This empirical assumption appears to be purely conjectural. The parties had stipulated that "Bobcat loaders are commonly used in the performance of construction work, but are also commonly used for work unrelated to construction." If one assumes the split between construction and nonconstruction use to be fifty-fifty, and further assumes the split between highway and nonhighway construction use to be fifty-fifty, the result is twenty-five percent—not a "small" percentage. One might also assume this figure to be larger yet, since the Bobcat loader is a small, four-wheel, rubber tire utility vehicle that might be more commonly used

175. See Third-Party Defendant-Appellant's Brief and Appendix, Appendix at 2 and Exhibit A (No. 85-2502).
176. See id.
177. 791 F.2d at 91.
178. See supra note 175, Appendix at 2.
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in small nonhighway construction projects than large highway construction projects. But all of this is equally pure conjecture.

Based upon the assumption that the percentage of loaders used for nonhighway construction was small, Judge Posner then assumed that there was a negligible likelihood that Hertz would make more careful inspections on the "off chance" that a loader would be used for nonhighway construction.\textsuperscript{179} Again, this assumption is based upon conjecture. Perhaps Hertz would make more careful inspections if it were subject to liability on even a small percentage of its rental agreements. In fact, the number of potential accidents is not dispositive; the amount of a potential judgment—especially with the greater risk present in the construction setting—would seem to be the more determinative factor. More important, however, Judge Posner's characterization of the question in terms of raising the level of precaution—i.e., that Hertz would "not make appreciably more careful inspections"\textsuperscript{180}—seems to approach the problem as if Hertz were subject to liability for nonconstruction accidents and highway construction accidents so that the potential liability from a small number of nonhighway construction accidents would not add to its already existing safety incentives. In fact, Hertz's standard indemnity contract is valid for nonconstruction accidents and highway construction accidents, so that its only incentive for safety (other than reputation) would come from nonhighway construction accidents for which the indemnity agreement is void under the statute.

Thus, Judge Posner's argument is not only built on speculative assumptions, but also is a flawed application of efficiency analysis. Moreover, paradoxically, the argument allows indemnification in the one and only category for which the legislature specifically sought to prohibit indemnification: the nonhighway construction category. The argument, if fully applied, would wipe out the entire statute, not just the "affecting" class of cases.

Finally, Judge Posner assumed that safety incentives would be appreciably impacted only if there were actual knowledge or reason to know of the intended equipment use in a particular case. It would seem, however, that a supplier would not wait for actual knowledge of each intended use before inspecting his equipment, but rather would inspect the equipment beforehand based on the aggregate of expected uses, including especially the nonindemnifiable nonhighway construction uses.

Both the reasoning and the holding in \textit{McMunn} are disturbing. The

\textsuperscript{179} 791 F.2d at 93.
\textsuperscript{180} Id.
use of efficiency analysis seems particularly inappropriate in this case. Judge Posner's assumption that the contract shifted liability to the party who could take precautions more cheaply rests upon the prior assumption that, as rational (and presumptively fully informed) self-interest maximizers, the parties otherwise would not have made the contract—a basic assumption of economic analysis of law.\(^{181}\) Whether the legislators would make this theoretical assumption, either in general or in the case at bar, is questionable. However, even if the legislators theoretically agreed with this view of human behavior, they clearly rejected efficiency concerns in adopting a law which invalidates indemnity agreements which are voluntarily entered into, and which are, by Judge Posner's presumption, efficient. Moreover, this broad "voluntary agreements are efficient" rationale, like the narrower "leases for nonhighway construction uses are too rare to affect safety incentives" rationale discussed above, would undermine the entire statute, not just the "affecting" class of cases. If indemnity agreements are viewed as a device for achieving economically optimal safety, the legislature clearly did not have economically optimal safety in mind.

Imputing efficiency concerns to the legislators was not only incorrect, but also potentially violative of federalism concerns. It is well settled that the duty of a federal court sitting in diversity jurisdiction is to determine state law as it believes the state's highest court would. Where the state supreme court has not spoken, the federal court must look for other indicia of state law. However, the federal court is not free to choose the rule it would adopt for itself.\(^{182}\) Under our federal system, if the State of Indiana chooses to adopt an inefficient law which interferes with voluntary transactions in order to pursue safety concerns, it may do so. Considering that efficiency appears to be one concern that the Indiana legislature clearly rejected in this case, it seems highly inappropriate to use an efficiency analysis to determine the scope of the statute.

From an actual (rather than economically optimal) safety standpoint, the connection between Hertz's indemnity agreement and Eichleay's construction contract was not nearly as attenuated as Judge Posner suggested. Hertz was a direct supplier of equipment used on a construction site. The indemnity agreement was between the supplier and the contractor. Contrary to Judge Posner's analogy, Hertz's role is not comparable to that of a "manufacturer of spark plugs" who supplies

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181. See supra text accompanying notes 22 and 73.
General Motors who in turn manufactures trucks that may be used at a construction site. Finally, from a practical standpoint, the scienter requirement that Judge Posner engrafted onto the statute creates uncertainty for business people and practitioners. It is now unclear which equipment suppliers will be within the scope of the statute. What goods are “specialized” to nonhighway construction? Does this mean the supplier of scaffolding will lose indemnification while the supplier of a bulldozer will retain indemnification even though both goods are used in the same building construction? This result, at least, could hardly have been intended by the legislature.

B. The Tabula Rasa Approach

In Remus, Judge Posner asserted that there was “no pertinent legislative history, . . . and no decision by a Wisconsin court interpreting the [Wisconsin Fair Dealership Law] in any respect pertinent” to the case. As such, he proceeded to interpret both the legislative purpose and intent by relying solely upon the words in the substantive provisions of the statute. Apparently, the key word in Judge Posner’s statement is “pertinent.” As discussed below, not only did the legislators expressly state the purpose of the statute, but both the Wisconsin Supreme Court and the Seventh Circuit had previously addressed the purpose, intent, and legislative history of the WFDL.

The stated purpose of the WFDL is, in pertinent part, as follows:

1. This chapter shall be liberally construed and applied to promote its underlying remedial purposes and policies.
2. The underlying purposes and policies of this chapter are:
   a. To promote the compelling interest of the public in fair business relations between dealers and grantors, and in the continuation of dealerships on a fair basis;
   b. To protect dealers against unfair treatment by grantors, who inherently have superior economic power and superior bargaining power in the negotiation of dealerships;
   c. To provide dealers with rights and remedies in addition to those existing by contract or common law.

The most frequently litigated issue under the WFDL has been whether a particular business relationship falls within the meaning of a “dealership.” In determining this issue, the Wisconsin Supreme Court

183. See supra note 77 and accompanying text.
184. 794 F.2d 1238 (7th Cir. 1986). This case is discussed supra text accompanying notes 91-116.
185. 794 F.2d at 1238.
has twice stated that the legislature "acted to protect 'dealers' from 'grantors' rather zealously, particularly with respect to the continuation of 'dealerships.' If a relationship is a dealership, the protections afforded the dealer are to be construed and applied liberally to the dealer." In one case, the Wisconsin Supreme Court stated that the WFDL was enacted "for the protection of the interests of the dealer, whose economic livelihood may be imperiled by the dealership grantor, whatever its size." In another case, the Wisconsin Supreme Court quoted a press release from the office of Wisconsin Governor Patrick Lucey which accompanied the introduction of the assembly bill in order to explain the purpose of the WFDL. The release stated:

This bill is intended to protect the thousands of small businessmen in Wisconsin who are franchisees. These businessmen operate filling stations, building materials and supply houses, lumber yards, sports equipment stores, motels, hotels and restaurant chains. They sell farm implements, clothing, furniture, and many other types of goods under a franchise system. The intent in this legislation is to protect these Wisconsin businessmen from pressure from a franchisor which is not in their best interests.

Moreover, the Seventh Circuit later quoted from this passage in Kealey Pharmacy & Home Care Services, Inc. v. Walgreen Co. in order to establish the legislature's intent. In Kealey, the court held that the WFDL prohibited Walgreen from terminating all of its pharmacy dealers in Wisconsin and replacing them with company owned stores. The court relied, in part, upon the legislative history of the law. In the course of enacting the WFDL, the legislature had considered but rejected an amendment which would have provided exceptions from the WFDL for actions taken by a franchisor to:

(a) vertically integrate;
(b) alter or adjust its marketing technique, scheme or plan;
(c) withdraw from a geographic marketing area; or
(d) dispose of through sale or lease, any parcel of real estate occupied by a dealer upon the expiration of the dealer's lease for the parcel as long as the parcel of real estate ceases to be the site of a branded outlet

188. Rossow Oil Co. v. Heiman, 72 Wis. 2d 696, 702, 242 N.W.2d 176, 180 (1976) (emphasis added). In this case the issue was whether the dealership agreement came into existence before or after enactment of the WFDL rather than whether the business arrangement was a "dealership."
190. 761 F.2d 345, 349 (7th Cir. 1985).
of the grantor. The court relied upon the legislature's refusal to adopt an exception for withdrawal from a geographic market as indicating that Walgreen's system-wide terminations should be prohibited. Analogous reliance in Remus could be placed on the legislature's refusal to adopt an exception for altering or adjusting a marketing technique, scheme or plan (subdivision (b) of the proposed exceptions). Indeed, the Remus case seems quite similar to the Kealey case: both involved system-wide restructurings to improve efficiency (maximize aggregate wealth) at the expense of individual dealers.

While the above history does not directly address the question of how far the statute was intended to extend, it clearly demonstrates that the legislature's focus was on dealer protection and fairness rather than efficiency. While some of the above language relates to protection from termination, other passages indicate much broader protection.

Although Judge Posner's writings on statutory interpretation emphasize the use of legislative history—as well as consideration of the values and attitudes of the period in which the statute was enacted—he declined to consider the above indicators of legislative intent and purpose. He presumed that the "statute's main purpose is to give dealers a kind of tenure," analogized the position of the franchisee to that of an employee, and focused instead on the aggregate wealth effect of Amoco's action.

Had Judge Posner given greater weight to both the dealer protection purpose of the statute and the dealer's position as a self-employed small businessman, he might have scrutinized the alleged harmful impact on the dealers more carefully. Remus and his class alleged that they received no discount and were simply charged for credit card sales so that Amoco’s revenues were increased at their expense. Judge Posner did not address these claims. He treated the question of whether Amoco's actions “substantially change[d] the competitive circumstances of the dealership” as one of interpretation rather than of fact. Finding that Amoco’s change was, in theory, economically sound, he held that the legislature could not have intended to prohibit it.

191. The proposed amendment appears in Kealey, 539 F. Supp. 1357, 1366 (W.D. Wis. 1982), aff’d, 761 F.2d 345 (7th Cir. 1985).
192. 761 F.2d at 350.
193. See supra note 58 and accompanying text.
194. Judge Posner did distinguish Kealey on its facts. However, he did not mention the legislative history on which Kealey relied. See supra notes 190-92 and accompanying text.
195. Remus, 794 F.2d at 1240.
196. Id. at 1241.
As in *McMunn*, Judge Posner's reasoning in *Remus* raises judicial role and federalism concerns. If the State of Wisconsin chooses to protect its small businessmen at the expense of efficiency, it may do so. It would seem, then, that a determination of whether the dealers in *Remus* were, in fact, financially harmed by Amoco's action was of prime importance. As discussed in Part II, the district court had found "without a doubt" that Amoco's action had changed the competitive circumstances of Remus' dealership.\(^{197}\) Given the procedural posture of the case (appeal from the granting of summary judgement to Amoco), a remand for a factual determination of the financial impact on the dealers was warranted.

C. The Ex Ante Approach

Professor Laurence Tribe, in criticizing the application of economic analysis to legal problems, described the "ex ante approach" as follows:

>[S]ophisticated judges who "appreciate" the economic system are pulled toward an ex ante approach, in which a court is interested less in doing justice in the case at hand than in creating sound rules to govern the behavior of the world at large. . . .

That is, if courts seek to do justice among the parties actually before them by merely slicing up the pie fairly, they must forfeit the opportunity to expand the pie as a whole by formulating an appropriate forward-looking and general legal rule.\(^ {198}\)

Writing as an economist, Judge Posner endorses the ex ante approach, stating that "justice and fairness [are] not economic terms" and that an economist is not interested in the financial consequences of a past accident.\(^ {199}\) "To the economist, the accident is a closed chapter. The costs that it inflicted are sunk. The economist is interested in methods of preventing future accidents."\(^ {200}\)

It is suggested that Judge Posner's opinion in *My Pie*\(^ {201}\) reflects the economist's ex ante approach to dispute resolution. From an equity standpoint, the wrongness of the decision is startling. *My Pie* acted in good faith. It had informed Dowmont and Debould of the IFDA requirements, had requested and received an exemption for the Dowmont franchise, and had provided Debould with a disclosure statement before executing the second franchise agreement. As Judge Eschbach con-

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197. *See supra* text accompanying note 104.
200. *Id.*
201. 687 F.2d 919 (7th Cir. 1982). This case is discussed *supra* text accompanying notes 117-66.
cluded in his dissent, My Pie committed no violations of the IFDA or, at the very most, a "hypertechnical violation" on the Dowmont franchise which Dowmont should have been estopped from asserting.\textsuperscript{202} With respect to the Dowmont franchise, applying for a second exemption would have been wiser (in retrospect) than lining out the Westmont address and substituting the Glen Ellyn address. With respect to the Debold franchise, My Pie merely collected payments for menus and T-shirts already sold. The payments in no way obligated Debold to purchase a franchise. There were no allegations of fraud. Moreover, even if My Pie's actions could be construed as minor violations, Dowmont and Debold failed to give notice of their election to rescind for three and one-half years and two and one-half years respectively (despite the ninety day limitation period for election) and failed to file an action until long after the IFDA statute of limitations had run. Not only was My Pie denied recovery of back royalties, but Debold's counterclaim for royalties already paid was reinstated on the basis of debatable, technical violations and Germain's highly suspect claim of ignorance,\textsuperscript{203} the credibility of which had not been addressed by the district court.

As discussed in Part II, the harsh result in My Pie seems explainable, especially given Judge Posner's ideology as demonstrated in his other decisions and writings, only by viewing the case as one in which Judge Posner focused upon efficient rule formulation vis-a-vis judicial administrability.\textsuperscript{204} Judge Posner was unconcerned with the injustice of possibly forcing My Pie to return years of back royalties when he reinstated the counterclaim. As a forward-looking legal precedent, however, the decision encourages future franchisors to strictly comply with the requirements of the IFDA so that the court docket will be reduced.

As mentioned above, Judge Posner suggests that a judge should try to figure out how the legislators would have wanted the statute applied to the case at bar. It is doubtful that the legislators would have wanted the IFDA to be applied so strictly as to ignore all equitable considerations. They included a ninety-day limitation period for rescission, one and three year limitation periods for bringing an action under the statute, and a

\textsuperscript{202} See supra text accompanying notes 145-51.

\textsuperscript{203} Germain claimed he did not learn of the violations until January, 1980, at a conference with his new attorney. However, he testified that he had read and signed a copy of the draft exemption request letter and that he was present when the final document was signed. 687 F.2d at 927 (Esbach, J., dissenting). Further, Beadle testified that Germain \textit{had informed him} that the exemption was required due to the disclosure requirement of the IFDA. \textit{Id.} Moreover, even if Germain and Beadle somehow did not know of the requirements at the time the Dowmont franchise agreement was executed, the disclosure statement for the Debold franchise \textit{stated on the cover in bold type} the requirements of the IFDA. \textit{Id.} at 929.

\textsuperscript{204} See supra text accompanying notes 165-66.
provision to allow *exemptions* from the requirements for disclosure. By ignoring what appears to be the intended limiting effect of these provisions, Judge Posner seems to have attempted to make My Pie simply an example for future franchisors.205

**CONCLUSION**

This article has presented several objections to the application of economic analysis to statutory interpretation. Methodologically, Judge Posner’s approach is objectionable for his use of unsupported empirical assumptions and theoretical assumptions that cannot be imputed to the legislators, his disregard of available indicators of legislative intent, and his focus upon efficient rule formulation in disregard of equitable considerations. Philosophically, Judge Posner’s approach is objectionable as usurpative of the legislative function and, thus, violative of the judicial role and potentially violative of federalism concerns.

PAULA M. TAFFE

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