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QUANTITATIVE METHODS

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Michael Kang and Joanna Shepherd on Party Influence in Partisan Judicial Elections

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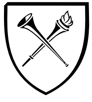
"Contributions from groups within each party coalition exercise a global influence on judicial decisionmaking by judges that goes beyond the parochial interests of the contributor's particular industry and instead is coordinated with other groups united by global ideological outlook."

—Michael S. Kang and Joanna M. Shepherd



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About *Emory Law Insights*

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Quantitative Analysis in the Pursuit of Policy Insight

The ascension of big data, modeling, and behavioral algorithms has upended the way we make decisions—quantitative analysis increasingly determines how budgets are spent and policy is written. Previously unnoticed patterns are turned into profit of one sort or another, in the asserted pursuit of increased efficacy and efficiency.

Quantitative studies are also a means to measure less visible behavior, including influences that some might prefer remain undetected, such as how much money influences state judges up for re-election, and when do waivers by a regulatory agency begin to undermine the rule to which they were meant as an exception?

Much of the research featured in this issue revolves around questions of money and power. Michael Kang and Joanna Shepherd's study, "The Partisan Foundations of Judicial Campaign Finance," looks at political parties' influence on state supreme court judges. Urska Velikonja's soon-to-be published article, "Waiving Disqualification: When Do Securities Violators Receive a Reprieve?" examines the Securities and Exchange Commission's grant of waivers from the Dodd-Frank Act's automatic disqualification provisions to executives and companies. Jonathan Nash and Rafael Pardo's study, "Rethinking the Principal-Agent Theory of Judging," finds the theory lacking, after reviewing it through the lens of student-loan-discharge proceedings handled by the bankruptcy court system.

Political parties influence more than elections

The foundation for Kang and Shepherd's analysis is a four-year survey of every state supreme court case—more than 28,000 cases and the decisions of more than 470 judges from all fifty states. On top of the case history, participants, legal questions presented, and outcomes, they overlaid variables including party affiliation; mandatory retirement laws; and political party and interest group contributions.

From that data, they found the Republican coalition received the best return on its investment.

Republican judges "do not appear to be affected at all" by campaign finance contributions from the Democratic coalition, they write. However, "as contributions from the Republican coalition increase, Democratic judges vote in a more conservative direction. Democratic judges thus respond in both directions to campaign finance pressures."

As the percentage of contributions from Republican interest groups increases by one percentage point, the study says, judges facing partisan elections are, on average, anywhere from 0.7 to 0.9 percent more likely to vote for the "conservative-preferred litigants" in any given case.

"Thus, as the percentage of total contributions from Republican interest groups increases by 10 percentage points … judges are, on average, 7 to 9 percent more likely to vote for these conservative-preferred litigants," Kang and Shepherd write.

Political parties' influence on the selection of judges is not a new phenomenon, as evident in the long history of efforts to insulate that process. But after *Citizens United v. FEC* made it legal for unions and corporations to spend unlimited amounts of money to advocate for or against candidates, their power promises to become even more pervasive.

"The major parties are by definition engines of political coordination that draw together sprawling coalitions of supporters and candidates into identifiable teams, allied internally by policy goals across every level and branch of American government, including state courts," the study reads. Their impact on the judicial process, as such, is a critical challenge to consider.

The appellate system's (limited?) impact on how judges rule

In challenging the principal-agent theory of judging, Nash and Pardo use the exceptional structure of the federal bankruptcy system as a basis to explore whether oversight and potential reversal by higher courts really influence the decisions of lower court judges. Specifically, they examine the dynamic of student-loan-discharge proceedings in consumer bankruptcy cases.

One weakness in the principal-agent theory is that federal higher court judges (the putative principals) are not in charge of selecting lower court judges (agents). Nor is a lower court judge's

career path typically determined by higher court judges—federal judicial nominations come from the president and are dependent on Senate approval.

In bankruptcy courts, by contrast, the relevant US Court of Appeals appoints trial judges for time-limited terms, and bankruptcy court decisions are appealed to the district court or to a bankruptcy appellate panel (BAP), if the circuit has created one.

"The [bankruptcy] system provides a more prototypical principal-agent relationship between higher and lower courts than do other systems in the federal law regime," Nash and Pardo write. Meanwhile, "BAP judges simultaneously sit on two courts—the BAP and the bankruptcy court. This provides an opportunity to observe how the same bankruptcy judge may change his voting behavior depending on his voting capacity—that is, as a trial judge or as an appellate judge." Drawing on data arising from that special case, they find the principal-agent theory to fall short. "We do not find evidence of voting behavior by bankruptcy judges," they write, "that would suggest sensitivity to the potential for principal monitoring."

With this study, Pardo added to his extensive body of work on what has emerged as an issue of national concern—how student loans have become an albatross of debt for many young Americans, from which bankruptcy seldom holds relief. Such loans have surpassed both auto loans and credit card debt to become "the largest form of consumer debt outside of mortgages," according to the Federal Reserve Bank of New York. In their work both together and separately, thus, Nash and Pardo are helping to move the policy discourse of the day.

SEC disqualifications hurt companies more than large fines

In her work, Urska Velikonja has explored both the governing structure of corporate America and the effort to police it. Her previous findings that independent corporate boards may not yield their intended results, and that shareholders are not the only (or biggest) losers when corporate malfeasance occurs, have already left a significant mark on the thinking of scholars and policymakers alike.

Most recently, she has examined the SEC's practice of granting waivers, especially after Section 926 of the Dodd-Frank Act authorized the SEC to add an automatic disqualification provision to Rule 506 of Regulation D, effective September 2013.

She argues that such disqualifications are much more painful for firms than fines, because they hamstring companies' ability to raise external capital without making a public offering—the easiest way for them to do so.

"Every year, companies raise almost $1 trillion in Rule 506 offerings, almost as much as they do in all public offerings combined," Velikonja writes. "For many firms, Rule 506 is the only provision they use to sell securities to investors."

In shedding light on the opportunities of executives and companies to escape the consequences of such disqualifications by way of SEC waivers, Velikonja once again stands to change the policy discourse in securities and corporate law.

Empirical studies and policymakers

As we see often in the legislative branches of government, there can be a significant gulf between knowledge and action. Can academic studies really affect law and policy?

Those with the potential to influence both have relied favorably on these professors' work in recent years.

This spring, Justice Ruth Bader Ginsburg cited Shepherd and Kang's study of money and judicial decision-making, "Skewed Justice," in her opinion in *Williams-Yulee v. The Florida Bar*. "Numerous studies report that the money pressure groups spend on judicial elections 'can affect judicial decision-making across a broad range of cases,'" Ginsburg wrote, quoting the study's finding that a recent "explosion in spending on television attack advertisements … has made courts less likely to rule in favor of defendants in criminal appeals."

Similarly, Velikonja's latest paper was cited in a speech by SEC Commissioner Daniel Gallagher earlier this year. Speaking on the issue of waivers, he called the paper "a new, insightful article that will be very important for this debate."

QUANTITATIVE METHODS

The Best Judges Political Parties Can Buy

Michael S. Kang
Professor of Law

BA, University of Chicago, 1993
MA, University of Illinois, 1996
JD, University of Chicago, 1999
PhD, Harvard University, 2009

Scholarly interests: courts and judges, business associations, election law, politics and democratic governance

Professor Kang's research focuses on issues of election law, voting and race, shareholder voting, and political science. His work has been published by the *Yale Law Journal*, *New York University Law Review*, and *Michigan Law Review*, among others. Kang also serves as coeditor of the book series *Cambridge Studies in Election Law and Democracy*, and coauthored a chapter for the first book in the series *Race, Reform, and Regulation of the Electoral Process*. Kang visited Cornell Law School during spring 2008 and Harvard Law School in spring 2009. He clerked for Judge Michael S. Kanne of the US Court of Appeals for the Seventh Circuit and worked in private practice at Ropes & Gray in Boston before joining Emory Law in 2004.

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Articles

Attacking Judicial Elections, 114 *Michigan Law Review* (forthcoming 2016) (with Joanna M. Shepherd)

The Brave New World of Party Campaign Finance Law, 101 *Cornell Law Review* (forthcoming 2015)

Sore Loser Laws and Congressional Polarization, 39 *Legislative Studies Quarterly* 299 (2014) (with Barry Burden & Bradley Jones)

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The End of Campaign Finance Law, 98 *Virginia Law Review* 1 (2012)

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To Here From Theory in Election Law, 87 *Texas Law Review* 787 (2009)

Race and Democratic Contestation, 117 *Yale Law Journal* 734 (2008)

Joanna M. Shepherd
Professor of Law

BBA, Baylor University, 1997
PhD, Emory University, 2002

Scholarly interests: analytical methods, law and economics, torts, health policy

Before joining Emory University, Professor Shepherd was an assistant professor of economics at Clemson University. In addition to her position at the law school, she also serves as an adjunct professor in the university's Department of Economics. Much of Shepherd's research focuses on topics in law and economics, especially on empirical analyses of legal changes and legal institutions. Her recent work has empirically examined issues related to the healthcare industry, tort reform, employment law, litigation practice, and judicial behavior. Shepherd teaches torts, law and economics, analytical methods for lawyers, statistics for lawyers, and legal and economic issues in health policy.

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Excerpt: The Partisan Foundations of Judicial Campaign Finance

Michael S. Kang & Joanna M. Shepherd

Money buys things. This is precisely the worry about money in judicial elections. As campaign spending in judicial elections has rapidly ramped up, there is increasing concern that judicial elections now have become "floating auctions" in which contributors purchase favorable judicial treatment in exchange for campaign financing. For sitting judges, the prospective need for money to finance their re-election looms over judicial decisionmaking and tempts them to decide cases in ways that attract, or at worst would not alienate, prospective contributors. Even the Supreme Court, which has hardly demonstrated great concern about campaign finance, recognized for the first time the potential for actual bias from big-money campaign spending in state judicial elections in *Caperton v. A.T. Massey Coal Co*.

What is regularly missed in this story of modern judicial campaign finance, however, is that Republican and Democratic parties play an indispensable role in the influence of money on judicial decisionmaking. The intuitive understanding of judicial campaign finance as a direct exchange of money for influence between individual contributors and candidates is far too simplistic to capture the larger realities of modern judicial elections. Of course, there is a very real relationship between contributions to judges and judicial decisions by those judges favorable to their contributors that we ourselves have helped document. However, in the modern world of judicial campaign finance, the Republican and Democratic parties broker the powerful relationships between contributors and candidates, particularly in partisan elections where their involvement is greatest.

The necessary role of the major parties in cementing the relationships between contributors and judicial candidates has nonetheless been underexplored and regularly overlooked. For example, the Supreme Court in *Caperton* held that the $3 million of campaign spending by Don Blankenship in support of Brent Benjamin's campaign for West Virginia Supreme Court Justice created an unconstitutional probability of actual bias in a later case where Benjamin, as a sitting justice, voted to overturn a large jury verdict against Blankenship. The court focused entirely on the relationship between the two men and money implicated in the case as if a political party, in this case the Republicans, played no role, not once mentioning the Republican Party in the decision.

However, Blankenship's financial support of Brent Benjamin was nested in a much larger, more complicated web of political influence where Blankenship exerted power through and with his party. What went unmentioned was the leadership role that Don Blankenship played in the state Republican Party. Blankenship, the CEO of Massey Coal Company, personally footed half the bill for the state party's new headquarters in his hometown of Charleston just two years earlier, and during the year of Benjamin's election, he coordinated a coal industry effort with the party to raise money from Massey vendors, investors, and other contacts exclusively for Republican candidates. The following year, Blankenship spent roughly $1 million in opposition to Democratic Governor Joe Manchin's pension bond proposal and other Democratic initiatives. In 2006, after vowing to spend "whatever it takes" to give Republicans control of the state House of Delegates, Blankenship spent almost $4 million in support of Republican candidates for state and federal office in West Virginia. The state Democratic Party chairman declared that "Don Blankenship is the Republican Party" in West Virginia.

The Republican and Democratic Parties serve as the critical networks between campaign finance contributors and judicial candidates, efficiently matching them and cementing the ongoing bonds between them. The major parties are by definition engines of political coordination that draw together sprawling coalitions of supporters and candidates into identifiable teams, allied internally by policy goals across every level and branch of American government, including state courts. Parties have always influenced judicial lawmaking at the state level, both by affecting which candidates are chosen for the bench and by swaying sitting judges toward their preferences through various means. The pivotal role of the parties in judicial elections today therefore should be quite familiar. After all, the historical evolution of methods for judicial selection, from appointment to election to new forms of merit selection today can be understood largely as state attempts to insulate judicial decisionmaking from pervasive partisan influence. Today, the parties simply assert their influence on state judges through the newly important channels of judicial campaign finance that have emerged as critically important over the past twenty years.

In this Article, we reveal the parties' pivotal role through judicial campaign finance in the first comprehensive empirical study of this scale on the subject. Analyzing an exhaustive database of all campaign contributions and state supreme court decisions over a four-year period, we provide robust empirical support for popular worries about partisan influence on state judges through campaign finance. The breadth of our data is unique and enables us to investigate the complex world of judicial campaign finance and the major parties as no study ever has. It includes every state supreme court case across all fifty states over four years, encompassing more than 28,000

cases and more than 470 judges. The data include variables that reflect case histories, case participants, legal issues, case outcomes, and individual judges' behavior. What is more, we incorporate comprehensive campaign finance data covering all contributions to judicial candidates during our period of study, with contributors sorted by industry based on information contained in disclosure reports and research on the donor's characteristics and agendas. The combination of data on judges, their decisions, and the campaign contributions they receive from the full range of contributors allow us to detail the relationship among judges, contributors, and the major parties.

As an initial matter, we identify broad left- and right-leaning political coalitions, allied roughly with the Democratic and Republican parties, whose collective contributions exercise systematic influence on judges who receive their money. These left- and right-leaning coalitions of contributors contribute heavily, though not exclusively, to their party's judicial candidates.

For the first time in the campaign finance literature, we find a systematic relationship between these partisan campaign contributions and the decisions of judges who receive them in the preferred ideological direction of the relevant party coalition. Contributions from the Democratic coalition are associated with judges voting in a liberal direction across their judicial decisionmaking, while contributions from the Republican coalition are associated with judges voting more in a conservative direction. In other words, our results indicate that contributions from groups within each party coalition exercise a global influence on judicial decisionmaking by judges that goes beyond the parochial interests of the contributor's particular industry and instead is coordinated with other groups united by global ideological outlook. We find this effect even controlling for the judge's ideological preferences. What is more, we find this effect more clearly for judges running for re-election, and therefore the potential need for campaign financing in the future, but less so for retiring judges with no such prospective worries.

We find this relationship between campaign contributions and judicial decisions mainly for judges elected through partisan elections where the major parties play their biggest role. This robust relationship between money and judicial decisions dramatically decreases for judges elected in nonpartisan elections. Although the party coalitions contribute money to judicial candidates in nonpartisan elections as well, the money appears to bear little relationship with judges' decisions when the parties play less or no role in brokering and mediating the relationships between contributors and candidates. In our data, the Republican and Democratic parties play a necessary role in money's influence through judicial campaign finance. If one is concerned about money's influence on judicial decisionmaking, it appears the real problem is parties, not elections, despite popular belief.

However, when we disaggregate contributions from the party coalitions, we discover yet another critical new insight into judicial campaign finance: campaign finance appears to exert strikingly different pressures on Republican and Democratic judges. A major study of campaign finance concluded that "the country doesn't have two major parties, it has just one: the money party." At least for judicial campaign finance, we find this true only in the limited sense that judges of both parties appear responsive to some sort of campaign contributions, but we also establish a very clear and important partisan asymmetry in judicial campaign finance between Republicans and Democrats.

For Republican judges, our results suggest that all the pressures from campaign finance influence them in the same conservative direction. Contributions from the Republican coalition are associated with Republican judicial decisionmaking in a more conservative direction, as are contributions directly from the Republican Party itself. Republican judges, though, simply do not appear to be affected at all by campaign finance contributions from the Democratic coalition. Campaign finance pressures for Republican judges seem simply to reinforce partisan discipline in the party-preferred direction.

By striking contrast, Democratic judges are torn in different, countervailing directions by campaign finance pressures. Yes, contributions from the Democratic coalition are associated with Democratic judicial decisionmaking in a more liberal direction, as are contributions directly from the Democratic Party. However, Democratic judicial decisionmaking also appears influenced by contributions from the Republican coalition. As contributions from the Republican coalition increase, Democratic judges vote in a more conservative direction. Democratic judges thus respond in *both* directions to campaign finance pressures. For Democratic judges, but not Republicans, campaign finance compromises party cohesion and discipline.

For seasoned political observers, this clear partisan difference may well resonate with anecdotal suspicion. As we discuss further, the Democrats have long had the reputation of being less organized and cohesive than their more disciplined Republican antagonists. But in judicial campaign finance, we find that the partisan structure of judicial campaign finance not only reflects critical differences between the parties, but it also reinforces them, perpetuates them, and helps explain them.

—from The Partisan Foundations of Judicial Campaign Finance, 86 *Southern California Law Review* 1239 (2013)

QUANTITATIVE METHODS

Casting Doubt on the Principal-Agent Theory of Judging

Jonathan R. Nash
Professor of Law
David J. Bederman Research Professor

BA, Columbia University, 1988
JD, New York University School of Law, 1992
LLM, Harvard Law School, 1999

Scholarly interests: administrative law, civil procedure, courts and judges, environmental law, federal courts, law and economics, legislation and regulation, property law

The study of federal courts and jurisdiction is one of Professor Nash's specialties, along with courts and judges, and domestic and international environmental law. Before coming to Emory Law, Nash served as the Robert C. Cudd Professor of Environmental Law at Tulane University. He has served as a visiting professor at University of Chicago Law School and Hofstra University School of Law and also has been a visiting scholar at Columbia Law School. His work has been published in *Columbia Law Review*, *Cornell Law Review*, *Iowa Law Review*, *Michigan Law Review*, *NYU Law Review*, *Northwestern University Law Review*, *Notre Dame Law Review*, *Stanford Law Review*, *Southern California Law Review*, *Vanderbilt Law Review*, and *Virginia Law Review*, among others. His scholarship has been cited by numerous courts, including the United States Courts of Appeals for the Sixth, Eighth, and Ninth Circuits.

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Rafael I. Pardo
Robert T. Thompson Professor of Law

BA, Yale College, 1998
JD, New York University School of Law, 2001

Scholarly interests: bankruptcy, commercial law, courts and judges

Professor Pardo joined Emory Law in 2012 and specializes in bankruptcy and commercial law. His scholarship has been cited by both US Courts of Appeals and US Bankruptcy Appellate Panels. Pardo began his academic career in 2003 at Tulane University and later served as professor of law and director of the Bankruptcy Client Representation Project at the University of Washington School of Law. Before entering academia, Pardo worked as an associate in the Business Reorganization and Restructuring Group of Willkie Farr & Gallagher in New York. He also clerked for the Honorable Prudence Carter Beatty of the US Bankruptcy Court for the Southern District of New York.

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Book Chapter

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Articles

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Excerpt: Rethinking the Principal-Agent Theory of Judging

Jonathan R. Nash & Rafael I. Pardo

Many commentators argue that a principal-agent model is helpful to understanding judicial hierarchies. Under the traditional principal-agent paradigm, the principal, having a set of goals in mind, selects an agent to fulfill them. The agent has a tendency to shirk rather than fulfill the principal's goals; the principal monitors—and can punish and even discharge—the agent to the extent that the agent observably fails to follow through on the principal's wishes.

Scholars have tried to fit the principal-agent paradigm to the setting of judicial hierarchies, describing lower courts as agents of their higher court principals. A superior court reviews a lower court in order to minimize shirking. It also crafts judicial holdings that will constrain the lower court's freedom to decide cases contrary to the superior court's preferences.

We challenge the underpinnings of the principal-agent understanding of judicial hierarchies. Specifically, we argue that the fit of the principal-agent model to this setting is worse than common wisdom would suggest. We begin by questioning the theoretical justification for applying the paradigm to judicial hierarchies. We then empirically examine whether judicial actors behave as the model suggests that they would, in a setting where application of the paradigm should be at its apex. We do not find evidence of such behavior.

In order to gain a better understanding of principal-agent theories of judicial behavior, we first survey other approaches scholars have advanced to unpack judicial behavior: the attitudinal approach and the strategic approach. The attitudinal model predicts that judges will vote their sincere preferences. The model does not ignore the fact that others—the legislature, the executive, the public, or other judges—may prefer to have judges cast votes different from those that they in fact cast. Instead, the model simply assumes that judicial independence is strong enough that these outside forces wield too little power to influence judges' votes.

The attitudinal model is at its theoretical apex when dealing with the votes of Supreme Court Justices, who enjoy life tenure and are in all likelihood unconcerned with the ability to ascend to another office. It is therefore not surprising that commentators have found strong evidence of the attitudinal model in Supreme Court voting, especially in certain areas such as criminal justice. Commentators have also found evidence of ideological voting by judges on courts of appeals in subject matters ranging from criminal justice and employment discrimination to administrative law, environmental law, and patent law.

Some scholars suggest limits on the attitudinal model, arguing that even Supreme Court Justices take into account how Congress and the president will react to a decision in deciding how to vote. Thus, for example, if a decision in line with a justice's true preference will predictably result in Congress and the president enacting a law that replaces the Court's decision with a legal standard that is even less desirable than the status quo, the justice may vote for the status quo notwithstanding what his or her pure personal preferences would dictate. Such concerns may also affect voting by judges on lower courts.

There are additional reasons to question the applicability of the pure attitudinal model to voting by lower court judges. First, there may be other constituencies that lower court judges wish to please. For one thing, lower court judges may seek elevation to a higher judicial post. On that account, they may seek to curry favor with the current president and Senate in order to facilitate selection for a higher court. For another thing, lower courts are subject to reversal by higher courts. One can say that the costs of reversal to lower court judges are low (or that the likelihood of reversal, especially by the Supreme Court given the minute percentage of cases it hears, is low). Still, a lower court judge may take a reversal as a public rebuke. Reversals may also adversely impact a judge's reputation. In the end, the specter of reversal may constrain lower court voting. Second, from a legal perspective, lower court judges are seen to be more constrained by precedent—and thus less free to vote ideologically—than are higher court judges.

Commentators have long understood a principal-agent relationship to exist between higher and lower courts in a judicial hierarchy. Higher courts review lower court decisions to constrain shirking; lower courts consider reversal a sufficient sanction to deter at least some shirking.

Yet there are weaknesses in the theoretical argument in favor of importing principal-agent understandings to most judicial hierarchies. Indeed, there are two reasons that this simple story is insufficient to describe the real relationship between higher and lower court judges. First, while principals ordinarily select their agents, higher court judges usually do not select lower court judges. Rather, in the case of the federal judiciary, higher court judges are stuck with lower court judges that the President has appointed with the advice and consent of the Senate.

Second, lower court judges may also cast votes with an eye to the possibility of elevation to a higher court. But once again, the higher court judges who review the lower court's decisions usually do not decide whether to elevate a judge from that court to

a higher position. In the case of the federal judiciary, that responsibility falls to the president and the Senate. At best, lower court judges may be seen to be potentially responsive to two masters: higher courts and the political branches.

In order to get better purchase on these theoretical problems, we empirically examine the application of the principal-agent paradigm to judicial hierarchies. We identify the federal bankruptcy litigation system as an area that allows for a natural experiment from which to tease out answers to these questions for the following reasons. First, the system provides a more prototypical principal-agent relationship between higher and lower courts than do other systems in the federal law regime. The bankruptcy judges who sit as trial judges at the bankruptcy court level are appointed for renewable time-limited terms by the court of appeals. Moreover, the court of appeals provides a second intermediate level of appellate review of bankruptcy court decisions. Bankruptcy court decisions are appealed first to the district court or, alternatively, to a bankruptcy appellate panel (BAP) if the circuit has created one. The circuit's judicial council, over which the court of appeals has dominant sway, selects BAP judges from among the circuit's bankruptcy court judges. BAP decisions, in turn, are appealed directly to the court of appeals.

Second, BAP judges simultaneously sit on two courts—the BAP and the bankruptcy court. This provides an opportunity to observe how the same bankruptcy judge may change his voting behavior depending on his voting capacity—that is, as a trial judge or as an appellate judge. One would expect a bankruptcy judge voting in his appellate capacity to be more sensitive to monitoring by the court of appeals. For one thing, BAP decisions are appealed directly to the court of appeals, whereas the appeal of a bankruptcy court decision must wend its way through the first tier of appellate review (i.e., either the district court or the BAP) before reaching the court of appeals, thereby making the bankruptcy judge's decision as a trial judge further removed from the watchful eye of the court of appeals. Moreover, while bankruptcy court decisions lack precedential effect, BAP decisions have precedential value and thus warrant greater scrutiny by the court of appeals.

To evaluate empirically the principal-agent theory of judging, we have collected data on the voting behavior of circuit court judges and bankruptcy judges (both as trial judges when sitting on the bankruptcy court and as appellate judges when sitting on the BAP) in student-loan-discharge proceedings in consumer bankruptcy cases. While analyses of the data provide support for the proposition that the ideological preferences of the circuit court judges predict their voting behavior, we do not find evidence of voting behavior by bankruptcy judges that would suggest sensitivity to the potential for principal monitoring. ...

... First, to explore the effect of voting capacity on the voting behavior of bankruptcy judges, we control for whether the judge cast his vote while sitting as a bankruptcy court judge (i.e., at the trial level) or as a BAP judge (i.e., at the appellate level). Approximately 51.8% of the votes in the Agent Dataset were conservative. Thus, in the absence of a relationship between the voting capacity of the judge and the direction of the judge's vote, we would expect to see the judges in our sample vote conservatively approximately 51.8% of the time. For votes cast by bankruptcy court judges, the judges voted conservatively approximately 54.2% of the time; and for votes cast by BAP judges, the judges voted conservatively approximately 48.9% of the time. The difference between the observed and expected values is not statistically significant ($p = 0.360$) according to a chi-square test with two degrees of freedom.

Second, to explore the correlation between the ideological composition of the circuit and the voting behavior of the bankruptcy judges, we fit a simple logistic regression model with the direction of the judge's vote as the dependent variable (coded 1 for a conservative vote and coded 0 for a liberal vote). The independent variable in the model is the ideological composition of the circuit, which we operationalize by using the median [judicial common space score (a standard measure of judicial ideology)] among all active courts-of-appeals judges in the corresponding regional circuit at the time that the bankruptcy judge cast his or her vote. ... There is no statistically significant association between the ideological composition of the circuit and the direction of the voting judge's vote. This finding holds true even when we control for the voting capacity of the judge.

... Our empirical study focused on an area in which one might have expected the principal-agent theory of judging to be robust. By selecting an area where the theory should have applied—if it applies anywhere—we can be more confident that, to the extent we find that the theory's predictions do not hold, there is something fundamentally wrong with the theory itself. Having found evidence suggesting that ideology influences the voting behavior of circuit court judges in student-loan-discharge determinations, but simultaneously failing to find evidence of conformist voting behavior by BAP judges, we contend that our results cast empirical doubt on the principal-agent theory as a construct for understanding the decision-making process of judges.

—from Rethinking the Principal-Agent Theory of Judging, 99 *Iowa Law Review* 331 (2013)

QUANTITATIVE METHODS

Why Financial Titans Fight for SEC Waivers

Urska Velikonja
Associate Professor of Law

LLB, University of Ljubljana School of Law, 2002
LLM, Harvard Law School, 2003
JD, Harvard Law School, 2009

Scholarly interests: business associations, business law, securities regulation, corporations, corporate law, corporate governance

Professor Velikonja teaches business law courses, including Securities Regulation and Mergers and Acquisitions. Her study of the SEC's practice of granting waivers from automatic disqualifications triggered by securities enforcement has attracted interest in Congress and was discussed by SEC commissioners. She has testified to the Public Company Accounting Oversight Board (PCAOB) about her work on the economic consequences of financial reporting fraud, which refutes the widely held belief that securities fraud primarily harms shareholders. Her work has been featured in the *Wall Street Journal*, *The Economist*, the *Financial Times*, and other media. Prior to entering academia, Velikonja clerked for Judge Stephen F. Williams of the US Court of Appeals for the DC Circuit and worked in an Austrian law firm in her native Slovenia. Velikonja will be a visiting professor at the University of Chicago during fall 2015 and at Duke University during spring 2016.

SELECTED PUBLICATIONS

Articles

Waiving Disqualification: When Do Securities Violators Receive a Reprieve?, 103 *California Law Review* (forthcoming 2015)

Distortion Apart from Price Distortion, 93 *Washington University Law Review* (forthcoming 2015)

The Politics of Securities Enforcement, 50 *Georgia Law Review* (forthcoming 2015)

Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions, 67 *Stanford Law Review* 331 (2015)

Team Production Theory and Securities Laws, 38 *Seattle University Law Review* 725 (2015)

The Political Economy of Board Independence, 92 *North Carolina Law Review* 855 (2014)

The Cost of Securities Fraud, 54 *William & Mary Law Review* 1887 (2013)

Leverage, Sanctions, and Deterrence of Accounting Fraud, 44 *UC Davis Law Review* 1281 (2011)

Negotiating Executive Compensation in Lieu of Regulation, 25 *Ohio State Journal on Dispute Resolution* 621 (2010)

Excerpt: Waiving Disqualification: When Do Securities Violators Receive a Reprieve?

Urska Velikonja

On August 20, 2014, after months of negotiations, Bank of America reached a settlement with the US Department of Justice, the FHA, Ginnie Mae, the FDIC, and several state attorneys general in a financial fraud action. The settlement arose out of the packaging, marketing, sale, underwriting, and issuance of residential mortgage-backed securities and collateralized-debt obligations. Bank of America agreed to pay a record-breaking amount in fines and other relief—$16.65 billion. On the same day, Bank of America also reached a provisional settlement with the Securities and Exchange Commission related to the same misconduct. It admitted wrongdoing and agreed to pay $245 million in monetary penalties. But the settlement with the SEC could not be finalized for months because of a disagreement regarding a seemingly minor point: waivers from automatic disqualification provisions.

Automatic disqualifications are collateral consequences of securities enforcement. Similar to felon disenfranchisement, they are triggered by certain enforcement actions related to violations of banking, financial, and securities laws. They bar defendant firms and individuals from serving as investment advisors, receiving marketing and referral fees from fund managers, relying on safe harbors from the mandatory securities registration requirement, and taking advantage of relaxed disclosure requirements for large public companies. While disqualifications are triggered automatically, the SEC has the authority to waive them for good cause.

Two factors have combined to make disqualifications in securities laws consequential. First and foremost, Section 926 of the Dodd-Frank Act of 2010 authorized the SEC to add an automatic disqualification provision to Rule 506 of Regulation D. Effective since September 2013, the disqualification bars affected firms and individuals from conducting private placements under Rule 506. The addition is significant because Rule 506 is by far the most popular provision for raising external capital without making a public offering. Every year, companies raise almost $1 trillion in Rule 506 offerings, almost as much as they do in all public offerings combined. For many firms, Rule 506 is the only provision they use to sell securities to investors. And second, several SEC commissioners have taken an interest in automatic disqualifications and waivers. Two Democratic commissioners have expressed concern that the SEC grants too many waivers to large financial institutions. By contrast, Republican Commissioner Gallagher has argued that automatic disqualifications should be waived almost always, except where the "issuer's financial reporting cannot be trusted."

The Article reviews the population of 201 bad actor and ineligible issuer waivers granted between July 2003 and December 2014, and identifies three significant trends in the SEC's exercise of waiver authority. First, large financial firms and their affiliates received a large majority of waivers, 81.6 percent. Smaller financial firms—those with fewer than 1,000 employees—and nonfinancial companies rarely received waivers, even though they were more often targeted in securities enforcement actions. The relative share of waivers issued to large financial firms is not necessarily a reason for concern. Large financial firms are probably more likely to request. Because only granted waivers, not waiver requests and denials are available to the public, the Article cannot say much about whether waiver practices are unfair. Nevertheless, the relative share appears large, but is not problematic if such firms are less likely to commit securities fraud than smaller and nonfinancial firms, either because of better self-policing or closer agency oversight. But there is limited evidence of either. Large financial firms also pay larger financial penalties than smaller firms, possibly in lieu of disqualifications.

Second, the study reports that the SEC's decisions regarding waivers lack transparency. The reasoning in waiver grants is formulaic, and the decisions rely on applicant representations, even where their representations lack credibility. Despite limited information on waiver practices overall, a closer look at the commission's decisions to grant waivers reveals coherent patterns. Firms charged with offering fraud, i.e., Ponzi schemes and accounting fraud, rarely receive waivers, presumably because a history of such violations indicates higher risk of fraud in disqualified offerings. Most waivers are granted to firms that violated broker-dealer rules and, to a lesser extent, investment adviser rules. The study suggests that the SEC grants at least some waivers too readily. For example, a relatively high number of waivers were granted to financial firms that packaged and sold Residential Mortgage-Backed Securities (RMBS), Collateralized Debt Offerings (CDO), and other mortgage securities in violation of securities laws, where a disqualification would have prevented the violation that had triggered it. In addition, some firms appear in the waivers data set a half dozen or more times. Repeat violations suggest a larger problem with compliance and raise doubt about their ability to self-police—and thus a red flag for future violations.

Third, the study reveals a shift in waiver practices over time. The number of granted waivers has

(continued on following page)

(continued from page 13)
declined since 2010, when an investigation by the Office of Inspector General (OIG) first revealed concerns that waivers were used as bargaining chips in settlements of enforcement actions. In addition, the SEC recently abandoned its practice to either grant a waiver in full or to deny it. Since the addition of Rule 506(d), the commission has issued a handful of limited and conditional waivers.

Part I provides background on collateral consequences against firms, on securities enforcement, and on automatic disqualifications in securities laws. Part II considers why the law disqualifies firms targeted by securities enforcement actions in addition to imposing direct penalties. It considers two rationales for automatic disqualifications—reducing the risk of repeat misconduct and enhancing the direct sanction. It also considers counterarguments for automatic disqualifications. Part III reports the results of an empirical investigation into the SEC's practice regarding disqualifications and waivers from automatic disqualifications. It discusses the many data limitations and summarizes the basic features of waivers. Part IV discusses in greater depth three specific observations: the lower likelihood of waiver where the underlying violation involves accounting or securities offering fraud, the disproportionate share of large financial firms that receive waivers, and the declining number of granted waivers. Finally, Part V proposes modifications to current SEC practices regarding automatic disqualifications. First, the Article proposes that lawmakers and regulatory agencies develop coherent rationales for automatic disqualifications in enforcement actions. Currently, disqualifications attach only to some exemptions in securities laws, but not all, without a principled rationale. Second, agency decisions regarding disqualifications and waivers ought to be transparent, publicly available, and provide meaningful justifications that are consistent with rationales underlying disqualifications. Third, the Article suggests that disqualifications can be useful enforcement tools in appropriate cases, against both large and small firms. Rather than waive all collateral consequences against large financial firms, the Article proposes using limited disqualifications, tailored to protect investors without being overbroad.

Collateral Consequences Against Entities in Securities Enforcement

Federal prosecutors have insisted that firms plead guilty and pay ever-larger penalties, but have worked behind the scenes to protect large-firm defendants from collateral consequences that otherwise accompany enforcement actions. Recently, a growing number of regulators have become disenchanted with the practice and have insisted that large firms ought to suffer the full legal consequences of their misconduct, just like smaller firms and individuals. This Part distinguishes between direct and collateral consequences of enforcement. It catalogues the most significant collateral consequences triggered by securities enforcement and discusses waivers for good cause as well as the impact of disqualifications on affected firms.

A. What Are Collateral Consequences? Any sanction, whether imposed after a guilty plea or resulting from a settlement of a class action, invariably exceeds the punishment imposed by the court or the consideration of the settlement. Large damages can render an individual or a firm insolvent. Sanctions in public enforcement actions are often greater than those in private suits, in part because the law automatically disqualifies defendants in public enforcement actions from enjoying civil benefits available to others. Different terms have been used to refer to automatic disqualifications triggered by public enforcement, including disabilities and collateral consequences.

The literature on sanctions distinguishes between direct and collateral consequences of an enforcement action. A consequence is direct if it is imposed by the agency or a court as part of the authorized punishment and is included in the order or judgment, ordinarily after a hearing. The direct consequence can be financial or nonfinancial: prison time, probation, disbarment, fine, disgorgement, restitution, a cease-and-desist order, injunction, or censure. A collateral consequence is an additional burden that is not included in the sanctioning order itself. Rather, it is a legal disability that is triggered upon resolution of a criminal or civil enforcement action. Because collateral consequences are usually imposed automatically by statute or rule, the court or agency does not consider whether they are appropriate for a particular defendant firm.

Collateral consequences against firms can include a revocation of a license to do business in a state or in a particular industry, such as banking or insurance. They can bar an accounting firm from auditing public companies, a bank from taking deposits from the public, or an investment company from managing its clients' money. Collateral consequences can be automatic or discretionary, permanent or temporary. Some only marginally increase the cost of doing business, while others can have profound effects on the firm, disrupt entire industries, and destabilize global markets.

—from Waiving Disqualification: When Do Securities Violators Receive a Reprieve?, 103 *California Law Review* (forthcoming 2015)

Faculty Scholarship

In addition to the faculty featured in this issue of *Insights*, other faculty at Emory Law have also authored works of empirical legal scholarship, including both quantitative and qualitative analysis.

William J. Carney

Charles Howard Candler Professor Emeritus of Law

Areas of expertise: business associations, securities regulation, corporate law

Charles Howard Candler Professor Emeritus of Law William J. Carney has taught and lectured internationally on corporate and securities law and published widely in the field.

Among his most recent empirical work, Carney's 2012 *Harvard Business Law Journal* article, "Lawyers, Ignorance, and the Dominance of Delaware Corporate Law," called into question the nature of Delaware's dominance of US corporate law. The article, written with Professors George Shepherd and Joanna Shepherd, is based on a survey of lawyers to determine their knowledge of competing corporate laws when selecting the state of incorporation. After querying lawyers and companies involved in initial public offerings, the authors concluded Delaware had created a kind of self-fulfilling prophecy. Because of Delaware's dominance, law schools focus on Delaware law "and a lawyer rationally learns the corporate law only of Delaware and her home state," Carney and his coauthors wrote. "Lawyers recommend only Delaware law because they believe that investors are ignorant of other states' law."

Carney has also empirically explored how businesses reacted after legislative attempts at corporate reform. "The Costs of Being Public After Sarbanes-Oxley: The Irony of 'Going Dark,'" 55 *Emory Law Journal* 141 (2005), examined the response of public corporations in exiting public markets following passage of the Sarbanes-Oxley Act—and the stated reasons for those exits.

In earlier work, Carney has written on corporate fraud, the competition for corporate charters, and the influences that lead to uniformity or variance in individual states' corporate law. "Vicarious Liability for Fraud on the Market: Theory and Evidence," written with Jennifer Arlen, was published in the *University of Illinois Law Review* in 1992. In the article, Carney and Arlen "examined a large sample of cases involving charges of fraud by public corporations, to determine if corporate liability would serve as a sufficient deterrent for future fraud," Carney explains.

"The Political Economy of Competition for Corporate Charters," 26 *Journal of Legal Studies* 303 (1997), compared various provisions of European Community law with US state laws "to determine how many European provisions were adopted by US states, and examined what forces would lead to such different approaches." And 1998's "The Production of Corporate Law," 71 *Southern California Law Review* 715, "examined important provisions of state corporate laws to determine the degree of uniformity, and the competitive forces that led to uniformity"—among the central questions of corporate law.

Faculty Scholarship

Kay L. Levine

Associate Professor of Law

Areas of expertise: criminal procedure, criminal law, regulation of sexuality

Associate Professor Kay Levine is currently producing a series of articles about state prosecutors, in collaboration with Wake Forest University Law Professor Ronald F. Wright. For this work, they interviewed 270 state prosecutors from nine jurisdictions in the American Southeast and Southwest.

Their 2012 article, "Prosecution in 3-D," 102 *Journal of Criminal Law and Criminology* 1119, addressed how an office's social architecture—the degree of hierarchy, specialization, and tendency to hire recent graduates or veterans—"contributes to the prosecutors' sense that they are independent contractors or part of a team," Levine says. A second article, "The Cure for Young Prosecutor's Syndrome," 56 *Arizona Law Review* 1065 (2014), uses interview and survey data from more than 200 prosecutors "to describe the maturation process most prosecutors seem to experience: from gung-ho adversarial hothead to multitasking, proportional, resource-conscious professional." A third, in-progress article explores the impact of this development on a prosecutor's risk of engaging in conviction psychology and wrongful conviction practice. The literature suggests prosecutors become more hardened, and thus more susceptible to wrongful conviction practice, over time. Levine and Wright's article, "Prosecutor Risk, Maturation and Wrongful Conviction Practice," argues that this is an overgeneralization. "For many prosecutors, the trajectory goes the other way," she says. "Particularly if office structures support the development of balance rather than zealotry."

Another forthcoming article from Levine and Wright, with coauthor Jenia I. Turner, is "Evidence Laundering in a Post-*Herring* World," to appear in the *Journal of Criminal Law and Criminology* later this year. The 2009 US Supreme Court case enlarged the scope of the exclusionary rule, inviting lower courts to admit evidence that had been illegally acquired. The article suggests state and federal courts' incorporation of the *Herring* decision "shifts the United States closer to nations that do not recognize exclusion as the presumptive remedy for constitutional violations by police."

Levine has also independently studied prosecution in the statutory rape context. The crime was defined in the US more than 150 years ago but was reinvigorated by a national debate about teen pregnancy in the 1990s, Levine says. Her four-year project included a survey and interviews with statutory rape prosecutors across California; about 90 percent of the state's 58 counties participated in the survey and 50 percent participated in interviews, she says. Her research suggests "statutory rape can be (at least partially) understood as an empty shell into which politicians and interest groups have poured their concerns in order to target unpopular portions of the population." The articles from that study are:

- The External Evolution of Criminal Law, 45 *American Criminal Law Review* 1039 (2008)
- The Intimacy Discount: Prosecutorial Discretion, Privacy, and Equality in the Statutory Rape Caseload, 55 *Emory Law Journal* 691 (2006)
- No Penis, No Problem, 33 *Fordham Urban Law Journal* 357 (2006)
- The New Prosecution, 40 *Wake Forest Law Review* 1125 (2005)

Faculty Scholarship

Alexander "Sasha" Volokh

Associate Professor of Law

Areas of expertise: law and economics, administrative law, privatization

Before joining the Emory Law faculty in 2009, Associate Professor Sasha Volokh earned his JD and PhD at Harvard University and clerked for US Circuit Court Judge Alex Kozinski and US Supreme Court Justices Sandra Day O'Connor and Samuel Alito. His interests include law and economics, administrative law and the regulatory process, antitrust, privatization, corrections, and legal history.

Volokh recently wrote a chapter for the book *Competition and the State* (Thomas K. Cheng, Ioannis Lianos & D. Daniel Sokol eds., 2014). Titled "Privatization and Competition Policy," the chapter provides an overview of economic models of privatization and explains the intersections of privatization and antitrust law.

His article, "Do Faith-Based Prisons Work?," 63 *Alabama Law Review* 43 (2011), reviewed all published studies on the effectiveness of faith-based prisons. He points out the methodological challenges of determining their efficacy and critiques the methodologies of the existing studies accordingly. His ultimate conclusion? "There's no good evidence that faith-based prisons work."

In his 2010 article, "Privatization, Free-Riding, and Industry-Expanding Lobbying," published in the *International Review of Law and Economics*, Volokh provides a theoretical model that shows "why, contrary to popular belief, prison privatization needn't lead to greater pro-incarceration lobbying, and may even lead to less lobbying."

"Property Rights and Contract Form in Medieval Europe" was featured in *American Law and Economics Review*. Volokh created a game-theoretic model of medieval agriculture, modeling the contract between a lord and a peasant, and the peasant's choice of how much effort to expend on agricultural work. "I conclude that the development of English law is a plausible explanation of why the mix of contracts between wage and rental contracts shifted over time and why the evolution of that mix of contracts was different in England than on the Continent," Volokh explains.

The premise of "Choosing Interpretive Methods: A Positive Theory of Judges and Everyone Else," 83 *New York University Law Review* 769 (2008), was to create an intuitive theoretical model of how result-oriented judges strategically choose methods of statutory or constitutional interpretation in order to better achieve the policy results they desire. Volokh points out judges have many interpretive methods available to them, and they may be strategic in their choice of which method to use. Judges who choose one method may be systematically different from judges who choose another. Thus, he writes, "Our views of what a particular interpretive method is like may be largely driven by the self-selection effect of which judges choose to use that method; the interpretive method might look very different if everyone were constrained to use it."

Volokh is also a regular contributor to the *The Volokh Conspiracy*, a law and public policy legal blog which he and his brother, UCLA School of Law Professor Eugene Volokh, founded in 2002. It has been hosted by the *Washington Post* since 2014.

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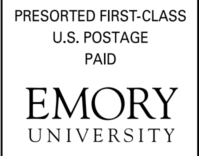
Office of Marketing and Communications
Emory University School of Law
1301 Clifton Road NE
Atlanta, GA 30322-2770



ALSO INSIDE

"Agency decisions regarding disqualifications and waivers ought to be transparent, publicly available, and provide meaningful justifications that are consistent with rationales underlying disqualifications."

— Urska Velikonja, associate professor of law