

## **Legal Transitions – Reliance Redux**

David Hasen

### Abstract

The recent literature on legal transitions is noted for its welfarist approach to the analysis of legal change. This approach tends to efface, and purports to debunk, a number of distinctions that are salient to conventional understandings of legal transitions. According to a welfarist analysis, these distinctions have no significant role to play in the analysis of legal change.

This article examines the theoretical apparatus on which a number of these criticisms are based, with a principal focus on taxation. The examination demonstrates that the apparatus suffers from significant conceptual shortcomings. They include the unwarranted assimilation of legal to factual change, the naturalization of conventional arrangements, and the unfounded disregard of the distinction between making law and finding it. The result is an account of legal transitions that is unable either to explain actual transitions or to provide a novel normative theory of how legal change should take place. In the end, the older view of legal transitions is more capable than the welfarist approach of providing an adequate normative and positive framework for understanding legal transitions.

## Legal Transitions – Reliance Redux

### I. Introduction

The academic literature on legal transitions has grown substantially over the last twenty-five years.<sup>1</sup> Its subject is the timing of legal change: When a new legal rule is announced, what rules or norms should govern the time at which it becomes effective? Further, what relief, if any, should be made available to those adversely affected by the change solely because they failed to anticipate it, and what charge, if any, should be imposed upon those who enjoy an unanticipated windfall from the change?<sup>2</sup> If Congress passed legislation tomorrow raising the top marginal tax bracket to 40%, in theory that rate could take effect tomorrow, sometime after tomorrow, or even have retroactive effect, applying to income earned in previous periods.

The contemporary analysis of legal transitions is overwhelmingly welfarist in orientation.<sup>3</sup> It adopts an anticipations-oriented approach to the analysis of legal change, and it takes as broad a focus as possible.<sup>4</sup> For example, one commentator has defined the term *legal transition* as the resolution of any uncertainty regarding future legal rules to the extent that the uncertainty affects decisions made currently.<sup>5</sup> Another has defined it as any change to legal entitlements.<sup>6</sup> From this broad perspective, commonly accepted distinctions among types of transitions, such as those between adjudication and

---

<sup>1</sup> Seminal treatments include those of Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PENN. L. REV. 47 (1977) [hereinafter Graetz, *Retroactivity*], and Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509 (1986) [hereinafter Kaplow, *Economic Analysis*]. More recently, Daniel Shaviro has provided a comprehensive analysis of legal transitions, with an emphasis on tax transitions. DANIEL SHAVIRO, WHEN RULES CHANGE: AN ECONOMIC AND POLITICAL ANALYSIS OF TRANSITION RELIEF AND RETROACTIVITY (2000). Additional extensive discussion is found in Volume 13, Issue \_\_, of the *Journal of Contemporary Legal Issues*, which is devoted to legal transitions.

<sup>2</sup> Louis Kaplow, *Transition Policy: A Conceptual Framework*, 13 J. CONTEMP. LEG. ISSUES 161, 165-68 (2003) [hereinafter Kaplow, *Conceptual Framework*] (discussing the scope of the transition question).

<sup>3</sup> Kyle D. Logue, *Legal Transitions, Rational Expectations, and Legal Progress*, 13 J. CONTEMP. LEG. ISSUES 211, 216 n.5 (2003) [hereinafter Logue, *Legal Transitions*].

<sup>4</sup> Saul Levmore (1999), *Changes, Anticipations, and Reparations*, 99 COLUM. L. REV., 1657, 1658 (1999) [hereinafter Levmore, *Changes*].

<sup>5</sup> Kaplow, *Economic Analysis*, at 512 (“The central feature of any transition situation is the existence of uncertainty concerning future government policy prior to the government action”).

<sup>6</sup> SHAVIRO, at 25-26.

legislation or scientific advancement and legal change, become largely irrelevant.<sup>7</sup> Because the resolution of uncertainty or a change to underlying entitlements may come about through a change to positive law, a judicial decision that “clarifies” the law, or even a scientific discovery that illuminates legally relevant physical laws, the transitions literature has discounted these distinctions, seeking instead to categorize all of them as more or less the same for purposes of analyzing legal change.<sup>8</sup> Relevant differences among the various types of change, to the extent they exist, relate largely to their presumptive temporal reach, and to a lesser extent to institutional concerns having to do with the distinctive ways in which different kinds of government actors may be compromised in their pursuit of public aims.<sup>9</sup> As examples, the default rule for changes to positive law is nominal prospectivity, but the default for judicially created “new rules” is nominal retroactivity. In the absence of a legislative directive to the contrary, newly enacted law takes effect on the enactment date, while in the absence of a court’s statement to the contrary, its ruling will apply both prospectively and to the prior conduct that is the subject of the case as well as to other persons’ prior conduct falling within the statute of limitations. These default rules in turn create distinct incentive effects, but what matters are these incentive effects, not the fact that, for example, one type of transition purports to constitute a new rule while another a clarification of an existing rule.<sup>10</sup> Similarly, log-rolling, the self-interest of individual legislators or interest-group capture may affect the prospects for favorable new rules from a legislative or administrative body, whereas parallel concerns in the judicial setting may have more to do with the role of the decision maker’s ideology or the institutional limits on her power to adopt favorable rules.

The ideas just discussed are commonly supported by the further assumption that what matters to private actors focused on wealth accumulation is the magnitude of the impact of unanticipated change on the value of their entitlements and obligations.<sup>11</sup> Actors are only secondarily concerned about whether a change is equitable, applies to past rather than solely to future conduct, or derives from legal change rather than market-

---

<sup>7</sup> See, e.g., Saul Levmore, *The Case for Retroactive Taxation*, 72 J. LEG. STUD. 265, 266 (1993) [hereinafter Levmore, *Retroactive Taxation*].

<sup>8</sup> See, e.g., Kaplow, *Economic Analysis*, at 515-19 (discussing the scope of the transition question); Logue, *Legal Transitions*, at 239-42 (discussing the transition issue created when a new discovery about causation of harm is made); Levmore, *Changes*, at 1671-72 (discussing judicial decisions).

<sup>9</sup> See Kaplow, *Conceptual Framework*, at 190-200.

<sup>10</sup> See, e.g., Kaplow, *Economic Analysis*, at 517; Levmore, *Changes*, at 1672 (“The argument for encouraging useful anticipation does not depend on whether new law comes about through legislatures or courts.”).

<sup>11</sup> Graetz, *Retroactivity*, at \_\_\_.

based events.<sup>12</sup> From the perspective of a private actor, the crucial question is the extent to which an unanticipated change affects her wealth.

In this article, I argue that the conceptual apparatus that underwrites the approach just described is flawed, and that the transitions analysis that rests on it is in many ways unpersuasive as a consequence.<sup>13</sup> Because the literature begins by assimilating all manner of changes to entitlements to a single model of quasi-factual change, it elides distinctions that are needed to explain background assumptions that the literature tacitly makes but cannot support under its own conception of legal change. These assumptions are both necessary for but inexplicable within a model that understands legal transitions as closely akin to market-based or natural change. If the assumptions are abandoned, the market model of legal change on which so much of the transition analysis rests collapses; if the assumptions are retained, the distinctions among the various types of legal change that the recent literature tends to dismiss need to be resuscitated. Once they are resuscitated, many of the tenets of the old view discarded under the new view regain their vitality.

As important as what I argue below is what I do not argue. I do not claim that the “new view” transitions literature has advanced wildly implausible normative or empirical claims, or that there is nothing to be gained from the anticipations-oriented approach it has adopted and developed. Nor, conversely, do I mean to suggest that proponents of the “old,” reliance-based, view identified the correct set of transition “norms.” Rather the claims here are that the current literature is analytically deficient, to some extent schizophrenic, and largely unable to generate defensible propositions about legal transitions that are different from those of, and not better understood within, the “old view” of legal transitions that it rejects. The analytical deficiencies include a failure to develop consistent definitions of such key concepts as “transition,” “legal transition,” and

---

<sup>12</sup> Michael J. Graetz, *Retroactivity Revisited*, 98 HARV. L. REV. 1820, 1826 (1985) [hereinafter Graetz, *Retroactivity Revisited*] (“[A]s a general guideline for justifying relief in legal transitions, the magnitude of economic gains or losses ought to be the crucial variable.”); Kaplow, *Conceptual Framework*, at 177 (“To private parties, gains are gains, losses are losses, and taxation and compensation of gains and losses have the same cost or benefit regardless of the original source of the effects being mitigated.”). No claim is made here that scholars in the new transitions literature have attempted to extend their analyses without qualification to non-“economic” areas of the law, such as the criminal law.

<sup>13</sup> Others have criticized the recent transitions literature as unhelpful, though generally on different grounds. See, e.g., Michael Doran, *Legislative Compromise and Tax Transition Policy*, 74 U. CHI. L. REV. 545 (2007) (arguing that a fixed transition policy would rob Congress of flexibility in adopting new legislation without offering any particular welfare benefits). In a similar vein, Mark Ramseyer and Minoru Nakazato have opposed to now dominant view that transition relief is typically a bad idea by arguing a requirement of grandfather relief when the law changes enables Congress to insulate itself from lobbying groups interested in retaining prior, presumably worse, law. J. Mark Ramseyer & Minoru Nakazato, *Tax Transitions and the Protection Racket: A Reply to Professors Graetz and Kaplow*, 75 VA. L. REV. 1155 (1989).

“transition norm”; the schizophrenia consists in the tacit reliance of new view theorists on some of the same transition practices that they criticize; and the literature’s inability to generate novel and defensible claims is evidenced by its failures to account for the differing transition defaults operative in the adjudicative and legislative arenas and to demonstrate that a reliance-based view is unable to reach correct results on the question of the proper default norms for changes to positive law and for judicial decisions that adopt new rules.

For purposes of the discussion, it is critical to keep in mind that because the focus of the transitions literature is transition norms or policy, and not specific transition rules that may arise in individual cases,<sup>14</sup> the analysis is not concerned with, nor does it particularly make claims regarding, the consequences of occasional departures from whatever norm may be appropriate. Rather the question is what is the best sustainable transition principle or policy on a long-term, steady-state basis. As a consequence, the claims advanced here neither purport to apply to every legal transition, nor are refuted by isolated examples of legal transitions in which the relevant governmental actor departs from a particular norm, whatever it may be. The question the literature seeks to answer is what norm or norms should apply in various contexts, and the observations made here relate to claims the literature has advanced in answering that question.

Part II provides a brief history of the transitions literature and describes the currently dominant approach to legal transitions. Part III examines the assumptions on which the approach relies, demonstrating that it suffers from significant failings. It then offers a reformulation of the contemporary, or new view, approach that provides a consistent and coherent way of conceptualizing legal transitions for purposes of that view. The purpose of developing the reformulation is not to identify the best conceptual apparatus for analyzing legal transitions, but only to offer an account that adequately operationalizes the new view approach. Part IV offers a criticism of the new view, and Part V demonstrates that the objections of new view scholars to reliance-based arguments for transition relief are largely unfounded.

## **II. Legal Transitions**

### **A. In general**

The legal transitions literature focuses on the question of the proper norm or norms that should govern the relationship between the time that a change in law is announced and the time the change becomes effective.<sup>15</sup> In short, it asks the question, When the law changes, when should that change take effect? Should it be at the time the fact of the change is established, such as when a newly legislated rule takes effect on passage; at an earlier time, such as a judicial decision that applies to past conduct; or sometime in the future, such as when a law is passed but is not scheduled to come into

---

<sup>14</sup> See, e.g., SHAVIRO, at 5; Kaplow, *Economic Analysis*, at \_\_\_.

<sup>15</sup> See, e.g., Kaplow, *Conceptual Framework*, at 163; SHAVIRO, at 1.

effect until a subsequent period? Subsidiary questions are whether and what kind of relief or penalty should apply to individuals who are affected by the change because of pre-change decisions they made in reliance on the old rule. Should individuals adversely affected receive transition relief in the form of grandfathering, phased implementation or some other method, or should they simply absorb the costs that result from unanticipated legal change? Should the unintended beneficiaries of legal change have the benefits taxed away, or is there some reason to allow them to retain some or all of the benefits? For each of these questions, the issue is what to do about the consequences of the transition that result from its having been unanticipated, not about the gains or losses that different individuals experience as a result of the new legal rule on a steady-state basis.<sup>16</sup>

The literature's paradigmatic example is the exclusion from gross income of interest earned on certain municipal bonds.<sup>17</sup> If Congress repealed the exclusion, then on a steady-state basis states and municipalities would be worse off, because they could no longer finance their operations with inexpensive debt. Instead they would have to pay interest at a rate such that, on an after-tax basis, the return from the bonds was the same as the return on comparable taxable debt. Similarly, investors in high tax brackets would be worse off, because they could no longer purchase comparable bonds having an after-tax yield as high as, or higher than, that available on municipal bonds.<sup>18</sup> Concomitantly,

---

<sup>16</sup> Thus, the fact that labor may be less favorably taxed under a consumption tax than under an income tax does not by itself create a transition issue on the shift from an income tax to a consumption tax. However, to the extent that individuals, prior to the transition, allocated more of their resources to the future production of labor income on the assumption that the income tax would continue indefinitely, a transition issue does arise on the shift to a consumption tax. See Kaplow, *Economic Analysis*, at 516.

<sup>17</sup> 26 U.S.C. § 103. Graetz made this example the focus of his analysis, and subsequent authors have done so as well. See Graetz, *Retroactivity*, at 54-57 & *passim*; Kaplow, *Economic Analysis*, at 515-16; Levmore, *Retroactive Taxation*, at 266 n.3 ("The tax-exempt bond example is a favorite of the legal transition literature."); Kyle D. Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 MICH. L. REV. 1129, 1133 (1996) [hereinafter Logue, *Opportunistic Retroactivity*] ("The classic illustration of these concepts involves the repeal of the exemption for interest on state and local bonds."); SHAVIRO, at 5-8.

<sup>18</sup> Historically, and for reasons that are not fully understood, the after-tax rate on municipal bonds has tended to exceed the after-tax rate on taxable bonds for individuals in the highest marginal tax brackets. See generally Calvin H. Johnson, *A Thermometer for the Federal Tax System: The Overall Health of the Tax System as Measured by the Implicit Tax*, 56 S.M.U. L. REV. 13 (examining the reasons for the failure of the market to capture all of the tax benefits available from municipal bonds). In theory one would assume that the market would fully impound the benefit and equalize the two returns. Among the possible explanations for its failure to do so are simple market inefficiencies and that the effective rate for the marginal investor on taxable bonds is lower than the statutory rate. *Id.*

issuers of taxable debt, such as the federal government and corporations, would be better off since they would not have to compete with non-taxable public debt.

However, the fact that in the long run these constituencies would suffer or benefit under a repeal of the bond interest exclusion is not the focus of the transitions literature. The considerations that go into the decision of whether to repeal the exclusion and, therefore, to increase the cost of financing to municipalities, decrease the cost to issuers of taxable debt, and reduce the benefits available to investors in formerly non-taxable debt are simply the considerations that determine whether the exclusion itself is good policy. They do not address the distributive or allocative questions that would result from the change to the new rule, as contrasted with the new rule itself. Rather the question the transitions literature seeks to answer is what, if anything, should be done about the fact that certain parties will be affected, positively or negatively, by their failure to anticipate the repeal at the time they made decisions that are affected by it.<sup>19</sup> If A purchased a 30-year tax-exempt bond in Year 1 and the exclusion were prospectively repealed in Year 2 without “transition relief,” the value of the bond would drop dramatically, and virtually all of the benefit of the exclusion would be lost to A.<sup>20</sup> Similarly, states may plan their future expenditures on the assumption that their costs of borrowing will reflect the reduced rate of interest they can offer on their debt. Future projects to which resources had been committed but for which bonds had not yet been issued would be affected by the repeal.

If one thought issuers or holders should be protected from these losses, then the effective date could be far into the future, or some sort of relief could apply, or both. For example, the repeal could take effect on a delayed basis, could be implemented in steps (such as by removing the exclusion for a fraction of the interest initially, with greater fractions removed in subsequent years), or the repeal could be applied only to bonds issued after the enactment date.<sup>21</sup> Conversely, if one thought that investors’ and issuers’ anticipation of new law would produce better outcomes overall than does their reliance on the availability of relief, one might favor immediate or even explicitly retroactive application of a repeal with little or no transition relief.

## **B. The theory of legal transitions**

### **1. Background**

As explained above, the principal normative question that legal transitions present is what the appropriate transition policy should be. Prior to Michael Graetz’s influential work on tax transitions, what has since become known as the “old view” of legal

---

<sup>19</sup> Kaplow, *Conceptual Framework*, at 165.

<sup>20</sup> See Graetz, *Retroactivity*, at 54-57, for a detailed discussion of the consequences of such an un-grandfathered repeal.

<sup>21</sup> See Graetz, *Retroactivity*, at 52-53, for a discussion of possible effective dates.

transitions held sway.<sup>22</sup> Under the old view, the rule that changes to positive law should take effect no earlier than on the date of enactment, or in certain cases, the date of public announcement,<sup>23</sup> typically rested either on the conventional idea that fairness demanded that individuals subject to the law be able to know what it is before they act, or on the fact that the inability to rely on the law at the time one made decisions affected by it created substantial inefficiencies.<sup>24</sup> By contrast, the retroactivity of judicial decisions was thought to be justified on the basis that adjudication states what the law already is; as a consequence, no unfair change to the rules arises when a new interpretation is announced.<sup>25</sup> Further, considerations of fairness, efficiency, or both generally were thought to support a norm of extensive transition relief for actors adversely affected by positive legal change.

For example, under the old view, the repeal of a tax preference such as the exclusion of interest on municipal bonds generally would be thought to require a grandfathering provision applicable to pre-repeal holders.<sup>26</sup> The grandfathering might be expansive, covering all interest earned on municipal bonds that were issued prior to the legal transition, or it might be narrower, applying, for example, only to interest received by pre-repeal purchasers. Whatever its scope, from a fairness perspective, it seemed that investors were entitled to at least some of the benefits of pre-repeal law since Congress had in effect “invited” reliance by passing the law; any change mid-stream would amount to an unfair bait-and-switch.<sup>27</sup> Similarly, from an efficiency perspective it was thought cheaper for Congress to implement tax policy if investors could rely on changes in law

---

<sup>22</sup> See SHAVIRO, at 2-3; see also Graetz, *Retroactivity*, at 48 n.3 (citing authorities).

<sup>23</sup> Not uncommonly, changes to positive law or to “legislative” rules are nominally retroactive to the date of announcement in the Congressional Record or the Federal Register. [CITES.] In the typical case, such changes address perceived failures of the pre-change regime to give effect to the intent of Congress or the relevant agency on the legal question in issue. Such changes, though legislative in form, are more akin to interpretive clarifications of prior law than to a genuine shift in policy.

<sup>24</sup> See, e.g., Feldstein, *On the Theory of Tax Reform*, 6 J. PUB. ECON. 77, 93-94 (1976) [CHECK.].

<sup>25</sup> Graetz, *Retroactivity*, at 49-50, & 73-79; Kaplow, *Economic Analysis*, at 515; see also SHAVIRO, at 112-15 (explaining the conventional basis for the retroactive effect of judicial decisions). Graetz’s article, which predated the more general theorizing of legal transitions, understands legal transitions to be traditional statutory change. As its title indicates, Graetz’s focus is tax transitions.

<sup>26</sup> [CITE.]

<sup>27</sup> See Logue, *Opportunistic Retroactivity*, at 1138-52 (discussing a justification of the “old view” rule under the “new view” rationale of a “default premium effect,” under which pre-enactment actors are efficiently induced to rely on legal change by the promise of transition relief should the law change).

that were designed to induce certain kinds of behavior.<sup>28</sup> From an *ex ante* perspective, the prospect that transition relief would accompany any future repeal enabled Congress to direct tax policy at the least cost in terms of the size of any tax benefits it did enact, because Congress would not have to provide investors with an additional premium to make up for the possibility that the benefits would be taken away, in part, on subsequent repeal.<sup>29</sup>

## 2. The “new view”

Graetz’s article marked a turning point in scholarly approach. He argued that in the tax context neither fairness nor efficiency considerations supported the widespread use of delayed effective dates or transition relief when the tax law changed. Under what has since become known as the “new view,” he suggested that these considerations did not point to any clear norm for tax transitions, though his work strongly intimates that a norm of no relief is more appropriate than a norm of relief in the context of economic regulation.<sup>30</sup> Broadly stated, Graetz adopted a two-pronged attack to the transition relief norm. First, he noted that almost any legal transition is likely to have ramifications for many parties beyond the typical beneficiaries of relief, but relief rarely applies to secondarily affected parties – nor, presumably, should it.<sup>31</sup> For example, the rules permitting accelerated depreciation for physical capital affect not only purchasers of favorably treated capital but also manufacturers of it, who are likely to increase production in response to stimulated demand. A repeal of the accelerated depreciation rules might be grandfathered for pre-repeal purchasers, but no existing norm would suggest that manufacturers who had invested in plant and equipment prior to repeal to construct favorably treated capital after it also would enjoy transition relief.

Second, Graetz argued that even on its own terms a strong transition relief norm could not be justified according to any of the standard measures ordinarily used to evaluate tax rules, including efficiency, reliance, horizontal equity, vertical equity, and social contract theories of government.<sup>32</sup> For example, the notion that a norm of transition relief avoided inefficient precautionary behavior by investors who would not take offered tax preferences at face value made unwarranted empirical assumptions about the costs of requiring individuals rather than the government to bear transition losses.<sup>33</sup> Graetz argued that in light of both the generally accepted view that markets are efficient

---

<sup>28</sup> See Graetz, *Retroactivity*, at 64-65 (summarizing this view).

<sup>29</sup> See Graetz, *Retroactivity*, at 69; see also Eric Chason, *The Economic Ambiguity (and Possible Irrelevance) of Tax Transition Rules*, 22 VA. TAX. REV. 615, 619 (2003). For a criticism of this argument on welfarist

<sup>30</sup> [CITE].

<sup>31</sup> Graetz, *Retroactivity*, at 77-78.

<sup>32</sup> *Id.*, at 63-87.

<sup>33</sup> *Id.*, at 64-73.

and the fact that legal changes are probabilistic events that affect the value of investments just as other unknowns do, it was more reasonable to assume that investors would more efficiently shed or assume the risk of legal transitions than would the government.<sup>34</sup> Similarly, the idea that reliance interests justified or required strong norms of non-retroactivity was largely question-begging. What constitutes reasonable reliance is itself a question that needs to be settled on the basis of other principles, since expectations are based on actual practices; they are not free-floating.<sup>35</sup> Because none of the standard fairness arguments supported a strong non-retroactivity norm, the case seemed weak on reliance grounds as well.<sup>36</sup>

Finally, and critically, Graetz's analysis suggested that the distinction between retroactivity and prospectivity on which so much of the older literature relied was arbitrary.<sup>37</sup> Once one recognized that transition gains and losses arise because rules that take effect in the future have an effect on the consequences of past conduct, the notion that legal change that was expressly directed at past conduct differed categorically from legal change that was only "forward looking" seemed mistaken. A forward-looking, ungrandfathered repeal of the muni bond exclusion could have nearly as great an effect on an investor as would an expressly retroactive repeal; the only difference would be in degree.<sup>38</sup> As a consequence, in thinking about possible transition rules, there was no reason in principle why new rules might not take effect retroactively, even if the rules were "legislative" rather than judicial, or articulations of "policy" rather than mere interpretations.

---

<sup>34</sup> *Id.*, at 64-66.

<sup>35</sup> *See id.*, at 74-75; Kaplow, *Conceptual Framework*, at 170.

<sup>36</sup> Graetz's criticisms of the reliance theory included the following: (1) the extent of reliance depends on individual assessments of the probability of legal change that can vary from person to person and that in the end provide no stable benchmark for assessing whether the reliance is reasonable; (2) the reasonableness of reliance depends on developments that change the calculation of whether reliance is reasonable; (3) apparently formal distinctions (such as whether the possibility of future repeal is made express or not) in the framing of legislation can affect the reasonableness of reliance; (4) relief tends to protect only a subset of those who relied on the old law; and (5) individual reliance on the possibility that a provision will be enacted does not seem different from reliance on a provision that is enacted and then quickly repealed, yet reliance in the former case does not entitle individuals to relief when the provision is not enacted. Graetz, *Retroactivity*, at 74-78.

<sup>37</sup> *Id.*, at 52-60.

<sup>38</sup> As an example, Graetz noted that the effect of the prospective repeal of the bond interest exclusion on a bondholder who was one year into the term of a bond would differ by just one year's interest from the effect if the repeal had been retroactive. *Id.*, at 60.

Subsequent commentary has generally carried forward Graetz's observations as a basis on which to make the case against a norm of extensive transition relief.<sup>39</sup> Equally significantly, it has appropriated Graetz's analogy of legal transitions to other market-based changes as a basis to expand the analysis to all forms of legal change. For example, Louis Kaplow describes a legal transition as any unanticipated change in the expected value of legal entitlements that results from government action.<sup>40</sup> Under this definition, legal transitions include not only changes to positive law, but also judicial and administrative decisions, executive actions, and even statements of policy, as long as, in each case, they were not fully anticipated before they became effective.<sup>41</sup> Further, because the definition includes resolution of any uncertainty (or the creation of any uncertainty) with respect to the future value of a present entitlement, a transition issue arises for Kaplow even if no actual change to a rule or policy has taken place.<sup>42</sup> Thus, the filing of a lawsuit on the basis of a novel legal theory would raise a transition issue, even if the lawsuit ultimately were found non-meritorious (a second transition issue).

Similarly, Dan Shaviro poses the transition question as arising under essentially the same circumstances as Kaplow does.<sup>43</sup> Kyle Logue characterizes a legal transition as occurring whenever there is an unexpected change to legal entitlements.<sup>44</sup> Thus, as under

---

<sup>39</sup> See Logue, *Legal Transitions*, at 216-220, for a review of the new view approach to legal transitions.

<sup>40</sup> Kaplow, *Economic Analysis*, at 517. The "government action" qualification is arguably not explicit, though Kaplow discusses it at various points in the exposition. *See id.*, at 517 & 518 (discussing changes in "government policy"). Further, if the qualification is not assumed, it becomes impossible to distinguish legal transitions from other kinds of transitions or events, such as those brought about by private actors. For a criticism of the definition as overbroad to the point of including virtually all activity that takes place or has consequences over time, see Frederick Schauer, *Legal Development and the Problem of Systemic Transition*, 13 J. CONTEMP. L. STUD. 261, 263-65 (2003). See also the discussion in Part III.A, below.

<sup>41</sup> *See, e.g.*, Kaplow, *Conceptual Framework*, at 166-67; SHAVIRO, at 25-26. The requirement of unexpectedness also implies that many transitions in the conventional sense do not raise transition issues because they are known about beforehand. For example, a change to tax rates scheduled to take effect in one year does not raise a transition issue.

<sup>42</sup> *See* Kaplow, *Economic Analysis*, at 517; Kaplow, *Conceptual Framework*, at 165 n.5.

<sup>43</sup> SHAVIRO, at 26.

<sup>44</sup> Logue, *Legal Transitions*, at 211-12. It is not clear that Kaplow would disagree with Logue's explication of the concept. Indeed, he cites the asbestos case as an illustration of the same logic that operates under a legal transition. Kaplow, *Economic Analysis*, at 524 & 524 n.35. However, as Kaplow states the rule, a scientific discovery, without more, should not count as a legal transition, because it is not government action. If non-government action is taken to constitute a possible legal transition, then Kaplow's definition of legal transition excludes virtually nothing and, most importantly, makes the concept of a legal transition indistinguishable from that of a market effect.

Kaplow's view, legal transitions arise both when the positive law changes and when a new interpretation of existing law comes into effect.<sup>45</sup> Logue also argues that legal transitions arise on scientific discoveries, if the discovery has the effect of altering legal entitlements. As an example, the discovery that asbestos causes cancer was a form of legal transition because it affected the legal entitlements of (among others) asbestos manufacturers, even though it did not involve "a change to the substantive liability rule."<sup>46</sup>

The motivation for this expansive interpretation of the concept of a legal transition derives from its welfarist roots. If the distinctions among types of legal change boil down to their different effects on asset values, then the distinctions become mere matters of degree,<sup>47</sup> not of kind. "To private parties, gains are gains, losses are losses, and taxation and compensation of gains and losses have the same cost or benefit regardless of the original source of the effects being mitigated."<sup>48</sup>

Similarly, the distinction between nominally prospective and nominally retroactive legal change is one of degree. At bottom, the legal transitions question is about the effect of unanticipated legal change on the value of entitlements. The fact that the effect is due to lack of anticipation, in turn, means that it is a form of retroactivity: Legal transitions affect the value of investments made prior to the transition, at a time when the fact that the new rule would become effective was not known. As Shaviro has put it, a change of this kind "reach[es] back into the past to alter the consequences of private decisions that preceded it."<sup>49</sup> From the perspective of a private investor, any unanticipated change to the law or its application that alters the value of investments acquired before the change is retroactive in effect. The only difference between explicitly, that is "nominally," retroactive effect and nominally prospective effect is that the former type of change will have a greater impact on asset values. There is no

### **3. The case for immediately effective, uncompensated transitions**

On the basis of the preceding account of legal transitions, Kaplow offered a powerful and influential argument for enactment-date effectiveness of most legal change, and against almost all forms of transition relief. The argument rests on two fundamental similarities shared by all legal transitions: that they raise the question of absorbing the costs of uncertainty, and that they appear to be no different in principle from ordinary

---

<sup>45</sup> *Id.*

<sup>46</sup> Logue, *Legal Transitions*, at 250.

<sup>47</sup> See Kaplow, *Economic Analysis*, at 517; Logue, *Legal Transitions*, at 239-42.

<sup>48</sup> Kaplow, *Conceptual Framework*, at 177.

<sup>49</sup> SHAVIRO, at 26.

market risks that investors must bear *ex ante*.<sup>50</sup> Because it is relatively easy to show under a wide range of assumptions that the optimally efficient method for absorbing market risk is private ordering,<sup>51</sup> Kaplow argued that from an efficiency perspective these features of legal transitions made the case against delayed effect and strong forms of transition relief practically overwhelming. He also argued that even enactment-date effectiveness should give way to nominal retroactivity in certain cases, such as where the prior regime turned out to have been undesirable during the period it was in effect.<sup>52</sup>

More recent scholarship focusing on the economic incentive analysis has tended to converge on the view that a norm of full nominal retroactivity should apply to a wide array of cases, including in general where it is reasonably clear that existing law is incorrect.<sup>53</sup> The analysis has likewise rested on the perceived parallels between legal transitions and other kinds of unpredictable events that affect the market value of investments.<sup>54</sup>

The efficiency argument for the superiority of private ordering over government relief in the market risk context is relatively straightforward. Consider Kaplow's example of a prospective builder or owner of a house on a flood plain.<sup>55</sup> If the individual must bear the costs of a flood in the first instance, she can be expected to make the optimal decision, from a social cost perspective, of whether and how to bear them – by absorbing the loss if she builds or owns and the flood occurs, by purchasing insurance (or self-insuring), or by building or owning elsewhere. By contrast, builders and owners who

---

<sup>50</sup> Kaplow, *Economic Analysis*, at 515-19. Following Kaplow, I use the term “market risk” to include “all risks – including the risk of natural events such as floods – not caused by uncertainty concerning future government policy.” *Id.*, at 533 n.62.

<sup>51</sup> *Id.*, at 532.

<sup>52</sup> *Id.*, at 551; Kaplow, *Conceptual Framework*, at 181-82. Whether nominal prospectivity constitutes transition relief is a point of contention. See Part IV, below.

<sup>53</sup> See generally Kyle D. Logue, *If Taxpayers Can't Be Fooled, Maybe Congress Can: A Public Choice Perspective on the Tax Transition Debate*, 67 U. CHI. L. REV. 1507, 1511-13 (2000) (reviewing SHAVIRO, WHEN RULES CHANGE) [hereinafter Logue, *Public Choice Perspective*]; Kaplow, *Economic Analysis*, at 551; Kaplow, *Conceptual Framework*, at 166. Note, however, that other “new view” authors have argued in favor of transition relief on a variety of grounds. Logue claims that an incentive analysis favors transition relief for tax preferences as the cheapest means of delivering the preference. See generally Logue, *Opportunistic Retroactivity*. Ramseyer and Nakazato argue that public choice considerations suggest that buying off powerful constituencies that have invested in prior law is the cheapest way to enact favorable new law. See Ramseyer & Nakazato.

<sup>54</sup> As Kyle Logue has summarized the point, “[s]ince we can count on investors to deal with transition risk on their own, our transition norm need not be concerned with it.” Logue, *Public Choice Perspective*, at 1512.

<sup>55</sup> Kaplow, *Conceptual Framework*, at 177-79.

can rely on a general policy of government relief from losses due to floods can be expected to over-invest in houses on flood plains because they do not need to bear the cost of a flood if it occurs. In effect, government insurance creates an externality by providing a costless put option for those who invest on land in flood plains.<sup>56</sup> Further, privately arranged risk-shifting and risk-spreading are almost certain to be superior to government-provided relief because the latter does not distinguish among the different levels of risk tolerance that different private actors have.

Turning to legal transitions, it would appear that if transition risk is analogous to natural or market-based risk, then it too should be borne in the first instance by private actors.<sup>57</sup> There are two aspects to the efficiency gain. First, private insurance remains more efficient than government relief, for the same reasons that it is superior in the case of market-based events. Both settings involve the question of absorbing the costs of uncertainty. Where investors must bear the costs of legal change in the first instance, they will spread or shift risk so that it is optimally allocated between themselves and others.<sup>58</sup> Second, forcing private investors to bear the risk of legal change will lead to beneficial pre-transition anticipation of future law, as long as it is reasonable to suppose that the law is generally improving. While this assumption has been aptly described as “heroic,”<sup>59</sup> it is at least reasonable as a working assumption or a first approximation.<sup>60</sup> Thus, if we think that strict product liability in tort provides a better regime than negligence for risk-bearing and -spreading, a transition norm that does not permit manufacturers to rely on transition relief will encourage them to act as though strict liability applied *avant la lettre*. Indeed, the prospect of retroactive application of such a regime is likely to have still greater beneficial effect. Such pre-transition changes in conduct produce welfare gains apart from the savings that private insurance provides over transition relief.<sup>61</sup>

---

<sup>56</sup> *Id.* One might object that forcing such individuals to bear these costs unfairly penalizes those who may lack the means to purchase insurance or to rebuild, possibly through no fault of their own. The usual response is that such hardships are due to pre-existing distributive inequities that should be dealt with in other ways, such as through tax-and-transfer programs that are not keyed to specific losses. Programs of this nature do not effect distributive objectives by means of inefficient subsidies. *See id.*

<sup>57</sup> Graetz himself raised this point, but it has been more fully developed in the later literature. *See Graetz, Retroactivity*, at 65-66.

<sup>58</sup> *See, e.g., SHAVIRO*, at 33.

<sup>59</sup> Levmore, *Changes*, at 1662.

<sup>60</sup> *Id.*; Kaplow, *Economic Analysis*, at 521.

<sup>61</sup> Logue, at 217 & 217 n.10 (citing authorities).

#### 4. Nominal retroactivity

More recently, Shaviro has offered an in-depth analysis of tax transitions and retroactive relief in his book, *When Rules Change*. Shaviro's work is marked by subtlety, analytical rigor, and generality in its relaxation of the assumptions that law is generally improving and that legislators act benevolently are relaxed.<sup>62</sup> However, although the book deepens and expands upon the analyses that Graetz, Kaplow and other new view theorists developed, it does not abandon their conceptual underpinnings.<sup>63</sup> Rather Shaviro adopts the welfarist orientation of the new view<sup>64</sup> as well as the new view's skepticism regarding the significance of popular distinctions thought to underlie retroactive versus prospective legal change.<sup>65</sup>

Shaviro's discussion of the anti-nominal retroactivity (ANR) norm in the tax context offers a particularly clear explication of the grounds for this skepticism.<sup>66</sup> The ANR norm is simply the prevailing idea that tax legislation ought not apply with expressly retroactive effect.<sup>67</sup> Shaviro's discussion purports to show that the ANR norm does not rest on any categorical distinction between nominally retroactive and nominally prospective transition rules but instead "is strongly rooted in popular sentiment, legislative practice, and perhaps even the Constitution as the courts are likely to interpret it."<sup>68</sup>

Shaviro begins by acknowledging the appropriateness of the ANR norm for what he calls "rules of the road," or matters of pure convention. These are cases in which the problem that the rule solves is primarily one of coordinating conduct among persons, rather than optimally conforming their conduct to an externally given constraint.<sup>69</sup> It does not much matter whether everyone drives on the left or the right; what matters is

---

<sup>62</sup> See Logue, *Public Choice Perspective*, for a review and appraisal of *When Rules Change*.

<sup>63</sup> As an example of refinement, Shaviro disaggregates the idea of a transition tax (or subsidy) from that of transition risk. The former is the component of a transition reflecting an expected overall reduction (increase) in returns from an anticipated rule change offered without transition relief, while the latter is simply the effect that uncertainty about the future has on asset values, even though on an ex ante basis the expected value of an asset subject to a future rule change remains constant. SHAVIRO, at 27-32.

<sup>64</sup> See *id.*, at 4 ("This book's framework is utilitarianism.").

<sup>65</sup> See *id.*, at 104.

<sup>66</sup> See *id.*, at 104-10. Levmore offers similar view. Levmore, *Retroactive Taxation*, at 266-78.

<sup>67</sup> SHAVIRO, at 104.

<sup>68</sup> *Id.* Shaviro's analysis thus may be thought of as developing observations first made by Graetz and later developed by Kaplow and others on this point.

<sup>69</sup> *Id.*

that everyone drives on the same side. Similarly, it does not matter whether the default taxable year begins January 1 or July 1; what matters is that the default applies to everyone in a given class.

It might seem that to acknowledge a set of cases in which the ANR norm would be inappropriate concedes the basic point, for if the ANR norm were entirely arbitrary, then it should have no proper application to any category of legal transitions other than by chance. But Shaviro's point seems to be simply that rules of the road should not have retroactive effect at all, be it through nominal retroactivity or through nominal prospectivity that does not provide relief.<sup>70</sup> Accordingly, when a rule of the road is adopted or altered, there is no particular reason either for the new rule to apply with nominally retroactive effect, or for transition relief not to be provided to those who relied on the old rule.<sup>71</sup> An arbitrary rule whose content is that it functions as a coordinating device typically provides no particular clue to individuals subject to it that they should anticipate its change. More importantly, no efficiency gain from eliminating retroactivity is likely to arise by dispensing with the ANR norm or transition relief for such cases, because the gains derive from the coordination of parties with each other, not from conforming the conduct of the parties to an independent state of affairs to which the rule responds.<sup>72</sup>

Shaviro contrasts rules of the road with tax rules whose significance consists at least in part in their furtherance of some independent policy. Despite the fact that the ANR norm extends to most such rules, the difference in real terms between express nominal retroactivity and express prospectivity is, in his view, essentially arbitrary for the now-familiar reasons first identified by Graetz and developed by Kaplow.<sup>73</sup> As Shaviro puts it, neither the apparent effect nor the apparent command of the ANR norm bars retroactive application of new legal rules. The apparent effect of the norm is to cause each period's events to be taxed under the rules in force at the time rather than at a later time; its apparent demand is that a prior period's events not be revisited by applying a later period's rules to them.<sup>74</sup> Shaviro notes two objections. The first is that the tax law often takes account of economic events many years after they occur.<sup>75</sup> A simple example

---

<sup>70</sup> See Part \_\_\_, above, for a discussion of the retroactive effect of nominally prospective rules.

<sup>71</sup> Although Shaviro does not expressly state that new rules of the road should be accompanied by transition relief, he elsewhere argues for transition relief for "accounting rule changes" – that is, changes that do not involve an alteration of legal entitlements on a steady-state basis. *Id.*, at 53 (explaining accounting rule changes), 102 (arguing for transition relief for such changes). Rules of the road would seem to fall into this category.

<sup>72</sup> *Id.*

<sup>73</sup> See Part II.B.2.

<sup>74</sup> SHAVIRO, at 106.

<sup>75</sup> Levmore makes the same point. Levmore, *Retroactive Taxation*, at 266-68.

is the taxation of accrued capital gain or loss on an asset in the year of disposition of the asset rather than in the years in which, and at the rates at which, the gains or losses economically accrued.<sup>76</sup> The second is that “completed” transactions from prior years may have been undertaken because of future tax benefits that could be repealed on a nominally prospective basis, before the taxpayer has a chance to reap the benefits of the pre-repeal decision. This is the now familiar example of a prospective and un-grandfathered repeal of the interest exclusion on municipal bonds.<sup>77</sup> Shaviro argues that because the tax rules under such subsequent regimes have an effect on the tax consequences of transactions completed in prior periods, “mere accounting considerations govern the definition of nominal retroactivity.”<sup>78</sup> That is, nominal retroactivity differs from nominal prospectivity only in arbitrary accounting details, because both apply to alter the consequences of completed conduct. Ultimately, Shaviro concludes that “[n]ominal retroactivity is inherently a formal, rather than a substantive, economic category.”<sup>79</sup>

Shaviro’s view can perhaps be made clear upon consideration of the argument that is sometimes made that nominally retroactive statutes differ from prospective ones in that the former apply to completed conduct and in this regard cannot function as guides to conduct,<sup>80</sup> whereas nominally prospective changes can so function. Consider the significance of this distinction with regard to the consequences of a pre-transition act that are unalterable. As previously discussed, if *B* purchased tax-exempt bonds prior to the repeal of the interest exclusion, the fact that the new rule is prospective only does not mean that it does not apply to consequences of the pre-transition conduct, just as a nominally retroactive rule would. There appear to be only two differences. First, the nominally retroactive statute applies to conduct, not just to its consequences, and second, its extent will be greater because it will apply to all the consequences of pre-enactment conduct (back to the effective date); the nominally prospective enactment applies only to current and future consequences. The second point is conceded by all, but if the issue is that there is a categorical distinction between nominal and merely “effective” retroactivity, the question of degree does not matter. The first point similarly loses its significance if one assumes that the purpose of the conduct – for example, the purchase of tax-exempt bonds – is to realize the consequences. Where the only concern is with the value yielded by the investment, there appears to be no reason to place independent significance on preserving the rules applicable to the conduct itself.<sup>81</sup> If, then, a nominally retroactive enactment reaches back into the past, it appears that a nominally

---

<sup>76</sup> See, e.g., SHAVIRO, at 106.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*, at 107.

<sup>80</sup> Munzer, at 391.

<sup>81</sup> See Kaplow *Conceptual Framework*, at 165

prospective one does too, and in the same way, as regards what actually matters about that conduct, which is its consequences.

### III. The Apparatus of New View Transitions Analysis

As explained above, the new view analysis of transition policy begins from the proposition that legal change is just like any other sort of random event that individuals need to take account of in arranging their affairs.<sup>82</sup> If so, then given the efficiency of markets, it generally seems best for investors to bear the risks of legal change, just as they do the risks of natural events that may affect the values of their investments.<sup>83</sup> Further, under the assumption that law is generally positive in direction, a norm of self-help encourages efficient anticipatory modifications to behavior that are absent under a norm of government relief. If it is a bad idea to provide a tax exclusion for interest on municipal bonds, then investors facing the possibility of repeal of the exclusion without transition relief will have a greater incentive not to invest in the bonds solely for tax reasons than will investors expecting transition relief on any subsequent repeal. The incentive will be greater still if the prospect of a nominally retroactive repeal is in play. Conversely, while transition relief may confer benefits such as providing welfare-enhancing redistribution, these benefits can be more efficiently provided through other mechanisms, such as transfer payments or progressive taxation.<sup>84</sup> Problems of public choice raise additional concerns, but it is not at all clear that they point in favor of a norm of transition relief; in fact they may suggest that no relief is closer to the optimal norm.<sup>85</sup>

This Part focuses more closely on the distinctions that the transitions literature has drawn in reaching these conclusions. Subpart A reviews Kaplow's influential account of legal transitions, demonstrating that it suffers from important conceptual difficulties. Subpart B offers a reformulation of the new view theory of legal transitions that addresses these difficulties. The object is to provide a conceptual framework that is up to the tasks that the new transitions literature sets for itself. Subpart B then draws out some of the implications of the view that have not been recognized by its proponents.

#### A. Transitions as responses to uncertainty in government rules or policy

Kaplow formulates the legal transition question as follows: "It is useful to define the transition question as arising whenever actors make decisions whose effects may be influenced by government policies that are not known with certainty at the time the decisions are made. . . ."<sup>86</sup> Thus, a transition issue arises when a decision has

---

<sup>82</sup> See, e.g., Graetz, *Retroactivity*, at 65; Kaplow, *Economic Analysis*, at 534.

<sup>83</sup> *Id.*

<sup>84</sup> Kaplow, *Economic Analysis*, at 579-80.

<sup>85</sup> See SHAVIRO, at 64-91 (discussing public choice concerns).

<sup>86</sup> Kaplow *Conceptual Framework*, at 165. Kaplow goes on to state: "Generalizing, . . . a transition issue will be said to arise whenever an act has future consequences and the legal regime applicable to those future consequences is not known with certainty at the outset." *Id.*

consequences that may be affected by as-yet unknown government policies. A decision to invest in tax-exempt municipal bonds raises a transition question because of the possibility of repeal without grandfathering. Similarly, a decision to purchase stock or debt raises a transition question because the government's future policy on interest rates is not known at the time of the investment, and that policy is likely to have differing effects on the value of stock and of debt. Even a decision to invest in, say, a medical education rather than physical capital raises a transition issue, because of the prospect of health care reform (among other possible transitions).<sup>87</sup>

The problem with Kaplow's definition is that it is too broad. Even if all future government action were nominally prospective, the legal regime applicable to the future consequences of an act could never be known "with certainty," any more than any other facts about the future can.<sup>88</sup> Therefore, under this definition every decision that has future consequences raises a transition question. Second, given the possibility that future policy may be explicitly retroactive, even decisions that lack future consequences may be affected by future government policy. In short, under Kaplow's broad definition of legal transitions, there is literally no decision that does not raise a transition issue. It is in theory possible for last year's income to be taxed again this year.<sup>89</sup>

Presumably Kaplow would avoid the latter problem through the tacit – and probably reasonable – assumption that in practice the decisions of government actors ordinarily are not retroactive, or at least they will only ever be retroactive, if at all, to a limited extent. Thus, Congress may repeal the exclusion on municipal bond interest tomorrow, but it is unlikely to extend the repeal to pre-enactment periods, and, even if it did, it is almost unimaginable that it would extend the repeal to ostensibly pre-limitations periods. Similarly, a judicial decision operating with normal retroactive effect would explicitly extend only as far back as conduct that fell within the statute of limitations or to cases already filed, not to all previous conduct. The problem with this qualification is that while such a limitation almost certainly exists as a practical matter, practical truths are of no service in the context of a project to determine what the practice should be. Indeed the current transition practice comes in for heavy criticism within the transitions literature on precisely the ground that it relies on ill-considered and even sentimentally maintained concerns for fairness or reliance that are projected onto assertedly

---

<sup>87</sup> *Id.*, at 166; Kaplow, *Economic Analysis*, at 516.

<sup>88</sup> See Schauer, at 263.

<sup>89</sup> See, e.g., Levmore, *Retroactive Taxation*, at 275-76; SHAVIRO, at 105-06. Kaplow recognizes that "[i]t is possible – and as will be explored, may sometimes be optimal – for new legal rules to apply to conduct entirely in the past. Hence, both acts whose effects are entirely instantaneous and those whose effects have fully transpired might be subject to subsequent reform." Kaplow *Conceptual Framework*, at 166. Yet he does not expressly draw the inference that this possibility implies that every act raises a transition issue. It is unclear whether he means to include literally every act as raising a transition issue, or whether he would qualify the definition in some way.

insignificant distinctions, such as nominal versus effective retroactivity and legislation versus adjudication.<sup>90</sup>

Even if this difficulty is set aside, Kaplow's understanding of what constitutes a transition issue remains too broad. Because he defines a transition issue as arising whenever a decision is made under uncertainty about future government conduct, the definition embraces decisions motivated both by government action and by government inaction.<sup>91</sup> Consider again a decision to invest in tax-favored municipal bonds. At the time of the investment, there is a small but finite probability that Congress will repeal the interest exclusion. Thus, a "transition issue" arises because of the uncertainty regarding future treatment of the interest. Assume that, one day after purchase, a senator on the Finance Committee mentions in an interview that "all options are on the table" regarding upcoming tax reform. Now the probability that the interest exclusion will be repealed in the next year has increased from 0.5% to 5%. A second transition issue arises. The day after, in response to a direct question about the interest exclusion, the senator clarifies that she does not currently consider repeal of the exclusion as a likely subject of reform. A third transition issue arises as the probability of repeal drops back to 0.5%.

While it is true that fluctuating probabilities of actual legal change affect the market value of investments, a treatment of legal transitions that attempts to account for changes to the value of investments that result from these mere fluctuations becomes a treatment of literally everything the government does or could do. It is simply unclear why a theory of government transition policy (as opposed to a theory of private risk management) should attempt to account for a range of conduct this broad; the notion that the government might adopt an affirmative transition policy to deal with the mere possibility of action would make a theory of legal transitions literally unworkable.<sup>92</sup>

The equivocation or at least ambiguity found in Kaplow's work on transitions is paralleled in the transitions literature generally. Logue, for example, more or less carries over Kaplow's definition.<sup>93</sup> Saul Levmore is similarly critical of the conventional understanding but does not offer a clear definition of the transition concept that would purport to clarify the difference between uncertainty regarding the future and a legal

---

<sup>90</sup> *E.g.*, Graetz, *Retroactivity*, at 49-50 & *passim*; Kaplow, *Economic Analysis*, at 517-19; Kaplow *Conceptual Framework*, at 167. Somewhat ironically, the basis for much of that criticism is the analogy drawn between legal transitions and natural or market-based effects, which, unlike changes to law, cannot be nominally retroactive.

<sup>91</sup> Kaplow acknowledges this point. *See* Kaplow, *Economic Analysis*, at 517-18.

<sup>92</sup> It is possible to imagine cases where government signaling regarding future rules or policy is so strong that failure to rely on the signal would be unreasonable, even though the policy never comes into formal effect. These cases, however, presumably arise infrequently.

<sup>93</sup> Logue, *Opportunistic Retroactivity*, at 1135 & 1135 n.24 (citing Kaplow's treatment of legal transitions in explicating the concept of a legal transition).

transition.<sup>94</sup> More generally, little attempt appears to have been made to elucidate the nature of a legal transition in light of the view that not just formal adoption of new law but any change to legal entitlements counts as a legal transition. If one is to reject the conventional understanding of a legal transition as a change to positive law in favor of this broader conception, it is appropriate to formulate the broader conception with some precision.

## **B. Reformulating the conceptual approach: Legal transitions as changes to legal entitlements**

The preceding observations suggest that a more precise, and narrower, formulation of the concept of a legal transition is necessary before it is possible to assess the new view. In the first section of this subpart I offer such a formulation, and I then draw out several consequences in the second section. The discussion anticipates the critical analysis in Part IV of several tenets of the new view.

### **1. Entitlement rules and transition rules**

In order to refine the concept of a legal transition, it is helpful to focus on the intuitions that give rise to the recent transitions literature. The most basic and widely shared of these is well articulated by Kaplow, which is that unexpected changes to legal rules can create winners and losers solely by reason of actors' failure to anticipate the change at a time when an investment decision ultimately affected by the change is made.<sup>95</sup> As previously indicated, for this purpose, the concept of investment decision is construed broadly to include decisions over matters that involve commitment of resources to any particular course of action.<sup>96</sup>

Implicit in the description is a distinction between underlying legal entitlements and rules that specify when distinct entitlements hold. Thus, the rule that interest earned on municipal bonds is excluded from gross income specifies an entitlement, as does its opposite. Similarly, a rule that, for example, loans for medical school would be forgiven for doctors working in low-pay practices constitutes an entitlement rule, as does the rule that such loans must be repaid according to their nominal terms. If the bond interest exclusion or the favorable rule on medical school loans were repealed, a rule would apply that specifies when the respective entitlement rules hold. That latter specification could

---

<sup>94</sup> See Levmore, *Changes*, at 1672 (“There may be important reasons to prefer courts or legislatures for some matters, but both are vehicles of change capable of encouraging useful anticipation. There is no reason to expect the division of responsibility between legislature and court to track the dividing line between instances where aggressive change is and is not appropriate. Moreover, if courts and legislatures are often substitutes and there is some reason to prefer one or the other venue for various regulatory matters, then comparable rules avoid creating incentives for players inefficiently to prefer one to the other.”)

<sup>95</sup> Kaplow, *Economic Analysis*, at 516. See also SHAVIRO, at 26.

<sup>96</sup> See Part II.B.

be express in the form of positively enacted relief, or implicit through the operation of some default rule, such as that changes to positive law are understood to take effect on the date of enactment in the absence of explicit legislation to the contrary. Whether express or tacit, such a rule is a transition rule.<sup>97</sup> Transition rules specify the temporal relationship between two distinct entitlement rules.<sup>98</sup>

As an example, one could reframe a statute repealing the bond interest exclusion effective one year after the date enacted as follows:

Entitlement Rule 1: Interest on municipal bonds is excluded from gross income.

Entitlement Rule 2: Interest on municipal bonds is not excluded from gross income.

Transition Rule: Entitlement Rule 1 shall be effective until one year from the date hereof, and Entitlement Rule 2 shall be effective for all dates on or after one year from the date hereof.

Framed in terms of the distinction between entitlement rules and transition rules, the transition question becomes, What policy (or norm or rule) should determine the amount of time between the date on which a government acts to change an entitlement rule (the “action date”) and the date on which the change (the “effective date”) occurs? The transition question, then, is a third-order meta-question about a second-order meta-rule: What (third-order) rule or norm should govern the (second-order) transition rules that determine when certain (first-order) entitlement rules apply?<sup>99</sup> A number of possible

---

<sup>97</sup> Stephen Munzer introduces a similar distinction in his early article, though it is not precisely the same as that here. See Stephen R. Munzer, *Retroactive Law*, 6 J. LEG. STUD. 373, 388 (1977) [hereinafter Munzer, *Retroactive Law*] (“The legal status of an act depends not on something inherent to that act, but on the relation the act has to the law or laws governing its status.”). The entitlement-transition rule distinction also is arguably implicit in Eric Chason’s treatment of legal transitions. See Eric Chason, *The Economic Ambiguity (and Possible Irrelevance) of Tax Transition Rules*, 22 VA. TAX. REV. 615, 620 (defining transition rules in temporal terms and characterizing the definitions as formal).

<sup>98</sup> Kaplow frames the question in terms of changes to the scheduled legal landscape rather than to future entitlement rules, a formulation broad enough to capture situations in which future law features planned changes to entitlement rules. Kaplow, *Conceptual Framework*, at 165 n.5. I dispense with a consideration of this phenomenon here, because an evaluation of it would require introduction of considerable complexity without advancing the basic argument. The complexity results from having to distinguish between entitlements that change where, by hypothesis, the change does not raise a transition issue, from entitlement changes that do. While the question of how to address the fact that the enacted optimal law may sometimes contain its own changes is important, it is conceptually distinct from the question at issue here, which is how to manage the shift from non-optimal to optimal, or at least more-optimal law, or from no-longer desired to now-desired law.

<sup>99</sup> See Kaplow, *Conceptual Framework*, at 169 (“[T]he [subject of transition] involves a sort of meta-problem.”). The literature also has addressed the still higher-order question of what the appropriate transition to the appropriate transition policy should be. Kaplow, *Economic*

answers, of course, are possible. One is that the action date and the effective date should be the same; another is that the action date should precede the effective date by some interval (delayed effective date); a third would be the opposite: that the effective date should precede the action date by some amount of time (nominal retroactivity). Other possibilities include having distinct transition rules for distinct groups (i.e., what is commonly termed “transition relief”): delayed effective dates to the extent that the investor holds investments that were subject to the old rule on the action date (grandfathering), and an action date effective date for all others; etc.

## **2. Implications of the entitlement rule/transition rule dichotomy**

Several observations about the method of conceptualizing legal transitions as changes to entitlement rules are in order. As a rule, these observations do not call into question the new view approach to legal transitions, but they do illustrate the ways in which the new view literature has elided important questions that it has raised. They also illustrate how one might go about analyzing more rigorously the approach the new view has developed.

### **(i) Transitions vs. transition rules**

The first observation is that the concept of a legal transition does not imply the existence of a transition rule. This conclusion follows from the definition of a transition rule as the rule specifying when two distinct entitlement rules apply to a type of arrangement.<sup>100</sup> It is logically possible, however, for there to be no rule, express or tacit, that specifies when two inconsistent entitlement rules apply. In such a case, the new entitlement simply supplants the old one and applies at all times.<sup>101</sup> While the existence of no transition rule does not ordinarily apply in practice, it is important to keep in mind the analytical distinction so that it is possible to formulate the transitions problem, as conceived by the new view, accurately – after all, it might be desirable in some circumstances to do away with transition rules entirely. (Recall that it was the dissatisfaction with the conventional limitation of legal transitions as changes to positive

---

*Analysis*, at 557-60; Kirk J. Stark, *The Elusive Transition to a Tax Transition Policy*, 13 AM. J. TAX POL. 145 (1996).

<sup>100</sup> Again, this definition was needed in order to support a conception of legal transitions capacious enough to include all alterations to legal entitlements, no matter their provenance, as the new view literature requires, while excluding changes to the value of investments that result from events that fall short of actual rule changes. A more conventional understanding of legal transitions would view them as changes to positive law (and perhaps “legislative regulations”) and therefore could bundle together what I have called the entitlement rule and the transition rule in the definition of legal transition.

<sup>101</sup> One might counter that the rule that the later-enacted or –adopted rule rather than the earlier obtains one constitutes a transition rule, but this rule simply specifies the source of law, not the determination of when law that emanates from that source applies. I thank Scott Shapiro for alerting me to this issue.

law that gave rise to the need for a definition that is neutral with regard to the time and manner of changes to legal entitlements.) One example that illustrates the idea of a transition without a transition rule is the analogous case of a change to scientific understanding – the shift, perhaps, from the Ptolemaic to the Copernican view of the solar system. When the Copernican view supplanted the Ptolemaic, there was of course no notion that the Ptolemaic had been correct at some time in the past; rather the thought was that the Copernican view had always been correct; it merely had not been recognized as such. The notion that a transition rule would apply in such a circumstance is meaningless.

A second, more familiar, example is that of ordinary judicial interpretation of positive law. If a court announces a new interpretation of a statute, the new interpretation may purport to explicate the true meaning of the statute – at least under a conventional view of adjudication, sometimes referred to as the declaratory theory.<sup>102</sup> Because the court’s interpretation states the meaning at the time of the conduct to which it applies, the interpretation typically applies with at least some retroactive force. Of course it does not literally apply with full retroactivity, but the reasons may be grounded in separate policy considerations, such as finality, not in the notion that the court’s interpretation says what the law means now but not at other times.

## (ii) Relevant anticipations

The second observation about this way of formulating the concept of a legal transition is that if no transition rule were the norm, the relevant anticipation (setting aside the fact that legal actors are mortal) would not be of the next legal change, but of the ultimate change to the “best” legal regime, or at least to the final one. The reason is that in the absence of a transition rule, the full retroactivity of every legal rule would nullify the prophylactic measures that investors would take with respect to all intermediate legal changes. This follows, again, from the distinction between entitlement rules and transition rules that is presupposed in the legal transitions literature. If only entitlement rules change when legal change occurs, then no temporal limitation on the new entitlement rule applies; the rule has full retroactive effect and the detriments and/or windfalls from the new regime apply to all time periods, past and future. For example, suppose it turns out that the “best” tax regime is some form of consumption tax, and it is assumed that legal change is positive in direction. If no transition rules operated in legal change, then investors far-sighted enough to recognize the ultimate direction of the law should *not* react to an intermediate repeal, under the current income tax, of the preference on municipal bonds by investing in other assets until the market price of muni bonds drops to reflect the anticipated repeal, even though investors will be subject to tax on all

---

<sup>102</sup> See Munzer, *Retroactive Law*, at 374 (“Under [the declaratory theory], if a court ‘overrules’ an earlier decision, it does no more than declare what the law has always been and apply it to the case at hand.”). See *id.*, at 374-81, There are serious difficulties with the declaratory theory, but the notion that judicial interpretation offers a pronouncement of what the statute or rule was at the time of conduct in question need not rely on the declaratory theory. *Id.*

interest they have ever received on such bonds when that repeal occurs.<sup>103</sup> Although the preference repeal would cause investors to pay tax on the preference and indeed with full retroactivity, that change itself would be nullified when the final shift to a consumption tax occurs, again with full retroactivity.

**(iii) Implied vs. express transition rules**

Third, a transition rule need not be express to be in effect. Returning to the municipal bond interest example, repeal of the exclusion for all interest accrued from the date of enactment forward would constitute adoption of a new entitlement rule and a transition rule, whether the effective date were spelled out in the statute or simply assumed under a default rule. The repeal would provide both a new rule about bond interest (that it is included in gross income) and a rule about the extent to which the old rule continued to apply to bond interest (that it remained valid for pre-enactment dates).<sup>104</sup> Thus, the fact that an entitlement rule change lacks an explicit transition rule is not determinative of whether one is in effect, because default or other rules may provide it. The legislative norm that in the absence of an express transition rule or effective date, new legislation takes effect on the date of enactment constitutes a transition rule, assuming that a legal transition is defined as the literature has defined it.<sup>105</sup> Similarly, the Constitutional ban on *ex post facto* criminal legislation<sup>106</sup> creates a mandatory transition rule for federal criminal statutes, in the sense of a limitation on retroactive application. Conversely, the default norm for judicial decisions is that no transition rule operates (apart from a separately provided statute of limitations and a separate rule for already decided cases), so that the absence of an express transition rule gives rise to full

---

<sup>103</sup> Shaviro discusses this example. SHAVIRO, at 109.

<sup>104</sup> Whether default norms operate in specified contexts to limit the effect of change temporally is a separate issue that merely goes to expectations that have developed and the reasons for them; it does not go to the nature of legal transitions themselves. For example, many legal changes ordinarily have full retroactive effect. The most common example is a new judicial interpretation of any pre-existing legal rule or doctrine. *See* SHAVIRO, at 112-15.

<sup>105</sup> *See, e.g.*, SHAVIRO, at 112 (“It has long been a truism that ‘statutes operate only prospectively, while judicial decisions operate retrospectively’ (quoting *Rivers v. Roadway Express, Inc.*, 511 U.S. 298, 311-12 (1994)). Again, the notion that the absence of an express transition rule implies that a default transition rule is in effect follows from the demands of the welfarist conceptual apparatus. A more conventional understanding of the concept of a legal transition would permit one to view a transition rule as in effect only when the effective date departed from the legislative default. This understanding, however, would be based on the notion that a change to positive law is a different kind of thing from a new interpretation of existing law. If one is prepared to make that distinction, then one may consistently go on to view the change from the pre- to the post-enactment regime as intrinsic to a legal transition, and therefore to view transition rules as applying only when an exception is made to the general rule of date-of-enactment effectiveness.

<sup>106</sup> U.S. CONST., art. I, § 9, cl. 3.

retroactivity for all cases not already settled or beyond the applicable statutes of limitations.

**(iv) Factual or scientific developments are not legal transitions.**

Finally, note that even the expansive definition of a legal transition offered here does not appear to embrace factual or scientific developments that have a bearing on legal entitlements, contrary to the claims of some new view theorists such as Kyle Logue.<sup>107</sup> To illustrate the idea that the category of legal transitions includes such developments, Logue uses the example of newly discovered scientific evidence demonstrating that a product causes a certain type of harm.<sup>108</sup> In the example, he assumes that an underlying strict liability regime is in place and does not change. He characterizes a court's decision to accept the new causation theory for the first time as a legal transition because the decision changes legal entitlements and the change was the result of the court decision (a governmental action) to accept the new theory.

The difficulty with this analysis is that the change to legal entitlements resulting from a scientific development appears to be no different from the change that such a development brings to the market value of an investment; only the governmental actor responsible for enforcing it differs. Suppose A owns a copper mine and it is discovered that copper is particularly useful in a new computer chip manufacturing process. The value of A's entitlement increases dramatically because the price of copper has risen. But this value will be accorded to A only on the assumption that the legal system will continue to protect A's property rights in the mine. The difference between this case and the products liability case is only the operative legal regime – property rights in one, and tort in the other. In each case, the legal regime continues to do what it always did, which is to assign legal entitlements and obligations according to an unchanged set of rules. Unless one is prepared to say that the discovery of the new use for copper creates a new entitlement rule, it appears one cannot say that the new theory of causation in tort does either.

#### **IV. Criticism**

Having worked through the implications of employing a more precise definition of the concept of a legal transition as it is understood under the new view, it becomes possible to evaluate the new view literature's claims about legal transitions directly. In this part I examine two such claims: first, that legal transitions are closely akin to factual or market changes, and second, that legal transition norms can be evaluated apart from certain questions of political legitimacy and authority that some transition norms might raise. The arguments made in this part give rise to a third set of questions that I take up in Part V: whether the new view in fact has much at all to say about legal transitions that

---

<sup>107</sup> Logue, *Legal Transitions*, at 219; See also Kaplow, *Economic Analysis*, at 524 (discussing a product discovered to be unsafe on the basis of new scientific evidence).

<sup>108</sup> Logue, *Legal Transitions*, at 239-41.

has not already been said before. The sequence of the discussion is intended to be progressive. The second claim developed in this part builds on the first, while the analysis of Part V follows naturally from the considerations discussed in this part. Once it becomes clear that legal transitions are not closely akin to factual changes, it becomes incumbent on new view theorists to offer a defense of the new view that does not depend on the analogy. When that defense fails, the question of the extent to which the new literature has made significant contributions to our understanding of legal transitions becomes salient.

#### **A. Analogy of legal transitions to factual developments**

As stated previously, the legal transitions literature frequently has relied on the analogy between legal and factual change as a basis for analyzing the optimality of certain transition norms. Kaplow offers perhaps the clearest statement of the analogy:

[W]here the focus is on private actors and government substantive policy is taken to be optimal, government-created risk and risk due to market or natural forces, as well as government mitigation of such risk, are almost precisely analogous. To private parties, gains are gains, losses are losses, and taxation and compensation of gains and losses have the same cost or benefit regardless of the original source of the effects being mitigated. Likewise, market relief for risk—whether through explicit insurance arrangements or implicitly, such as through diversified financial ownership—is in principle equally effective regardless the source of the risk.<sup>109</sup>

It is important to bear in mind that the analogy is meant to function as more than a casual observation about the parallels between legal and market transition risk. Rather it amounts to a restatement of Kaplow’s “demonstration that uncertainty concerning government policy is analytically equivalent to general market uncertainty.”<sup>110</sup>

The distinction between entitlement and liability rules developed in the previous part provides useful purchase on the question of whether the analogy is accurate or persuasive. As explained there, entitlement rules specify underlying legal rights and obligations, and transition rules specify the temporal conditions under which the former apply. As also explained, this highly generic definition of legal transitions follows from the requirement that all forms of legal change or development be grouped together

---

<sup>109</sup> Kaplow, *Conceptual Framework*, at 177. For other statements, see Graetz, 1985, at 1825 (“The costs of uncertainty in the law do not seem necessarily different in kind or in magnitude from the costs of uncertainty in markets . . . .”); Logue, *Rational Expectations*, at 221 (noting reasonableness of market analogy assuming investors are rational).

<sup>110</sup> Kaplow, *Economic Analysis*, at 520. See also Kaplow, *Conceptual Framework*, at 179 (“Because government-created risk is analogous in relevant respects to market and natural risks and because government mitigation of gains and losses is inefficient with regard to the latter, it follows that it must be inefficient with regard to the former.”). See also Chason, at 616-17 (describing the Graetz-Kaplow view as based on the analogy between the risk of repeal and the risk of market-based or casualty losses).

without regard to the nature or authority of the decision maker initiating the transition or to what gives rise to the decision maker's decision. Although a conventional understanding of legal change would not need to insist on abstracting entitlements from meta-rules regarding their temporal application, that course is unavailable under the new view because of the expansive view of change it adopts.

Once the distinction between entitlement rules and transition rules is accepted, however, it becomes apparent that a legal change has a different kind of effect from a market-based development, because market changes do not reach back into the past in the way that a mere change in entitlement rules does. Unlike an uncompensated legal change regarding the availability of government relief for floods, the fact of the flood itself does not mean that flooded land was always flooded. Nor, for that matter, does it mean that the land became flooded sometime "before" the flood (in analogy to a partially retroactive legal change) or sometime after it (in analogy to a delayed effective date for a new legal rule). The "announcement" date of the change to entitlements, in the case of a factual change, is typically the same as the change itself. When it is not (as when there is warning that a change will come), it still occurs on some particular date, prior to which it had not occurred.

From the proposition that a legal transition implies only a change to entitlement rules, it follows that the most one can say about the similarity of legal change to factual or market change is that a legal transition plus a transition rule that takes effect on the date of "announcement" is "almost precisely analogous to" market change. The problem, of course, is that this formulation demonstrates that the analogy is entirely question-begging to the extent it purports to support rules of enactment date effect and no transition relief, since the issues in the transitions literature are precisely whether the new rule should take effect on the announcement date or on some other date and whether transition relief should be available. To say that a transition norm of having identical effective and announcement dates is like a factual change is merely to state the consequence of one possible transition norm: announcement date effectiveness. It does nothing to justify the transition norm itself. One can put the question in the converse: Consider that if it were possible to have unexpected factual developments take place on a date different from their "occurrence," would one assume that the optimal date would be the occurrence date?

One might accept these observations but counter that they reflect a merely semantic point: If one defines transition rules as meta-rules that determine the temporal extension of entitlement rules, then of course any legal transition that is not fully retroactive will be accompanied by a transition rule and in that sense by transition "relief." It is possible to resolve the problem by saying that a legal transition consists of a change to an entitlement rule plus a transition rule, which may or may not be explicit. Then the argument would be that legal changes, so defined, are just like factual developments. They happen unannounced, taking effect from some date forward, and we expect investors to deal with them through market mechanisms. The problem with this claim is that it is false. Legal changes differ from factual developments just in that they

can apply retroactively or prospectively rather than when they are expressly adopted. To say that investors should bear the costs of legal transitions on analogy with natural or market-based uncertainty disregards both the flexibility inherent in legal change, which is that there is in principle much control over the effective-date timing of the new entitlement rule, and the fact that it is just this flexibility that gives rise to the “transition question” in the first place. If the flexibility were lacking, there would be no transition debate because all changes to legal entitlements would (necessarily) occur on the date of announcement, or perhaps on some other date, but in any case on a date over which one had no control.<sup>111</sup> In short, the validity of the analogy presupposes the decision that the best transition rule is the default rule for changes to positive law, yet the analogy is used to justify that decision.

## **B. Problems with a single transition “norm”**

The difficulties with the analogy of legal change to factual or market-based change point to the crux of the problem with the anticipations-based literature. The failure to appreciate fully either the flexibility or the limitations inherent in the power to adopt a transition rule means that the new view literature fundamentally fails to account for what is distinctive about legal transitions. On the limitations side, it fails to recognize that the markets that provide efficient methods for managing certain risks and internalizing costs, and that serve as models for legal transitions in the literature, themselves depend upon the existence of a stable legal regime. Certain transition norms would undermine that stability and, hence, would vitiate or destroy the markets that are supposed to function as models for managing risk, including “transition risk.” On the flexibility side, the new view fails to appreciate the distinctive benefits that different transition “norms” can offer depending on the different type of, and justification for, the adoption of a new entitlement rule. For example, there may be distinctive and systematic reasons favoring greater retroactivity for judicial action than for legislative action, and these distinctive reasons may relate to the nature of the type of legal change the respective actors initiate, rather than, for example, to the capacity of the respective institutions to adopt “good” or “bad” law or to be influenced by rent-seeking or other undesirable behavior.<sup>112</sup> If one insists on treating all forms of government action as essentially the same, these distinctive reasons become invisible.

---

<sup>111</sup> Note that Kaplow himself does not accept the analogy fully, for if transition uncertainty were “analytically equivalent to general market uncertainty,” Kaplow, *Economic Analysis*, at 520, the notion that it might occasionally be appropriate to make certain new rules nominally retroactive would be false, contrary to Kaplow’s assertion. *Id.*, at 551 (“Sometimes new legal rules should be made fully retroactive: they should be applied to time periods before the enactment date, even as to investments no longer in existence”).

<sup>112</sup> Thus, Kaplow acknowledges that different norms for different types of government actor may be appropriate, but he does not ground the observation in the different nature of what the actor does; rather the focus is on the susceptibility of different government actors to different forms of suboptimal behavior. Kaplow, *Conceptual Framework*, at 190-200.

The limitations point can be illustrated by considering the consequences of extending the default rules that apply to judicial decisions to positive law, while the flexibility point can be illustrated by considering the reverse extension. These potential extensions (or some other uniform norm) should seem natural under a conception of legal change that insists on effacing the distinctions among judicial, executive and legislative decisions, because whatever the correct norm or norms should be, they should not depend upon which government actor initiates the change, but on which rule creates the proper incentives to legal actors.<sup>113</sup>

### **1. Retroactive relief – the naturalization of the market**

To illustrate the failure of the new view to recognize limitations on possible transition rules, consider the consequences of extending the judicial rule of nominal retroactivity to positive law. New view scholars have noted that such a norm would have a chilling effect on investors, for the obvious reason that they would lack confidence that the rules on which they relied in arranging their affairs would in fact be the rules applicable to their affairs.<sup>114</sup> Unless they could be sufficiently certain either that current law would not be changed unfavorably, or that if it did change, the retroactive effect would not extend far enough back to reach their earlier conduct, they would be unlikely to commit their resources in ways that would otherwise be efficient. For example, taxpayers under an income tax could be expected to allocate their resources in ways that favor current consumption to a greater extent than would taxpayers under a consumption tax. Unless taxpayers believed they could make an accurate prediction of the likelihood that a future transition to a consumption tax will occur and will apply retroactively to pre-change decisions, they are apt to adopt a wait-and-see attitude and to refrain from committing resources either way.

This analysis, while not technically incorrect, is importantly incomplete. Moreover, it has not been universally accepted. For example, Kaplow argues in favor of norm of nominal retroactivity when prior law was bad law for the period it was in effect.<sup>115</sup> Levmore, though he does not argue in favor of a norm of nominal retroactivity, suggests that occasional use of nominal retroactivity can result in substantial efficiency gains.<sup>116</sup> The problem with these views is that a nominal retroactivity norm would do more than make investors hesitant to make new investments for fear of expropriation of gains on repeal; it would create enough uncertainty in the stability of established law to

---

<sup>113</sup> Levmore, *Changes*, at 1672. To be clear, here I abstract from considerations relating to “good government” concerns that might counsel in favor of different norms for different government actors. See the previous note. Rather the question is whether the distinctive types of activity that different government decision makers engage in might support different transition norms for these actors. On this point the literature is silent.

<sup>114</sup> See Levmore, *Retroactive Taxation*, at 277-78; SHAVIRO, at 21-22.

<sup>115</sup> Kaplow, *Economic Analysis*, at 551.

<sup>116</sup> Levmore, *Retroactive Taxation*, at 275-77.

make reliance on markets as a means of managing risk unreasonable at all. Indeed, it would make investors question the validity of the legal regime itself, and, moreover, in ways that a norm of enactment-date effectiveness would not, even if the impact on investments in the latter case (assuming no worries about political stability were raised) were systematically greater than those in the former.

The difficulty stems from the fact that a norm of retroactivity of positive law is inconsistent with the terms on which political authority is constituted in a democratic polity, one of which is consent.<sup>117</sup> Consider that a genuinely retroactive pronouncement, such as taxation of a prior year's income, does not merely call into question the fixity of any rule that one might follow presently. It also implies that the currently operative legislature has departed from the rules that determine who is the legislator; in particular, it has usurped the role of the body that was authorized to act as legislator during the period to which the nominally retroactive enactment applies.

The point can be made clear by considering the following fanciful example. The object of the example is not to prove or even suggest that any amount of nominally retroactive positive law will lead to political collapse, but only to indicate the logical difficulties that arise in distinguishing between norms of nominal retroactivity and norms of nominal prospectivity solely on the basis of the extent to which the two types of legal transition affect the market value of investments. Suppose a neighbor appears at your doorstep with the pronouncement that she has just proclaimed herself the law on the basis of her decision to amend the Constitution, and that among other new rules taking immediate effect is one that transfers all of your property to her. You might counter that her proclamation has no legal effect because she hasn't followed the rules set forth in the Constitution that provide for its amendment to make her the new legislator. But the same is true in the case of retroactive legislation: A prior legislature, elected to govern during term *T*, followed procedures set forth in the relevant legal document and thereby established that law *L* would apply during that period. Later representatives (chosen by others) have now determined that *L* did not apply over *T*. If that is true, then the legal regime operative during the putative tenure of the prior legislature was not established by its electorate; it was established by a subsequent electorate. That can only have been through a valid exercise of authority (rather than through force) if the subsequent legislature validly amended the rules that determine who was the legislator during *T*. But the subsequent legislator did not follow the procedures set forth in the relevant document to do that. The difference between retroactivity adopted by a subsequent legislature and by your neighbor looks like it boils down to the power and not the right of either to adopt the change. Your neighbor is unlikely to be effective, but Congress is – at least in isolated circumstances.

---

<sup>117</sup> See Harold M. Hochman, "Rule Change and Transitional Equity," in *REDISTRIBUTION THROUGH PUBLIC CHOICE* (Harold M. Hochman & George E. Peterson, eds. 1974) 320, 331 (noting the problem of violation of consent that arises in similar case in which earlier generations set fixed rules for later ones).

This usurpation probably underlies the objections that nominal retroactivity is “obnoxious,”<sup>118</sup> unfair,<sup>119</sup> or inconsistent with “the fundamental principles of the social compact,”<sup>120</sup> as well as what gives rise to considerable uproar when nominal retroactivity is employed on even a sporadic basis.<sup>121</sup> When elevated to the status of a norm, a nominally retroactive transition regime for positive law would call into question the authority, and therefore the legitimacy, of the lawmaker.

A proponent of the new view might respond that no lawless usurpation of power is implied in retroactive legislation because implicit in the earlier enactment, as in all legislation, is the possibility that it might be overruled retroactively by a later legislator; conversely, no consent for your neighbor to adopt new rules is implied. Once accepted, however, there is no way to limit such a principle to the substantive statutory law; it could apply equally to any statement that purports to set forth who is entitled to say what the law is, including the neighbor’s claim about the earlier constitution.<sup>122</sup> From a conceptual standpoint, at the top of the chain of authority must lie agreement by everyone who would be bound.<sup>123</sup> That agreement cannot be amended other than by unanimous consent; otherwise, any subsequent change lacks authority for those who do not consent. This principle does not mean that even the highest level document cannot have procedures for amendment that call for less than unanimity, but it does mean that a departure from the rules for amending the highest-level document that are set forth in that document would be lawless for anyone who opposed it. The notion that such an agreement would contain tacit rules for specifying how that agreement may be altered is

---

<sup>118</sup> Munzer, at 391.

<sup>119</sup> See Graetz, *Retroactivity*, at 49 (quoting Committee on Tax Policy, New York State Bar Ass’n, *Retroactivity of Tax Legislation*, 29 TAX LAW. 21, 28 (1985), to the effect that retroactive taxation creates a sense of unfairness).

<sup>120</sup> Story, *quoted in* Kaplow, *Economic Analysis*, at 518 n.16.

<sup>121</sup> For example, the application of higher tax rates enacted in August 1993 to all income earned in 1993 resulted in protest, even though the legislature in office during most of the period was the same as the enacting legislature. See SHAVIRO, at 105.

<sup>122</sup> This observation may help to explain the courts’ oft-stated view that retroactivity that extends to the beginning of the current legislative period raises no constitutional question, but retroactivity extending much beyond it does. See *U.S. v. Carlton*, 512 U.S. 26, \_\_\_ (1994) (O’Connor, J., concurring) (“A period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise, in my view, serious constitutional questions.”).

<sup>123</sup> [CITE.] The point is similar to Rousseau’s observation in *On the Social Contract* that legitimate rule must be unanimously authorized. See JEAN-JACQUES ROUSSEAU, *ON THE SOCIAL CONTRACT*, Bk. I, Ch. 5, p. 52 (1978, Roger D. Masters ed., Judith R. Masters, trans.) (“The law of majority rule is itself an established convention, and presupposes unanimity at least once.”).

inconsistent with the nature of the agreement, since it is the failure of tacit rules regarding who governs and how that gives rise to the need for express ones.<sup>124</sup>

A related counter-argument is that discussed previously:<sup>125</sup> To private actors, the significance of their conduct is the results it produces. Whether a new rule applies with nominal retroactivity or merely affects the consequences of completed pre-transition conduct going forward does not particularly matter when the reason for engaging in past conduct is to reap benefits that will only come in the future. To the extent the pre-transition conduct is made on the expectation of benefits lasting into the post-transition period, the new rule that is not accompanied by transition relief applies no less to pre-transition conduct than does a retroactively applicable new rule. In other words, it does not matter whether the new rule affects conduct or the consequences of conduct that were its *raison d'être*. This argument, however, overlooks the fact that all law must be provisional as regards the future, because no one knows what the future will be. By contrast, the past is known with certainty. For this reason, it makes eminent sense to distinguish between consequences of pre-transition conduct as yet unrealized, and pre-transition conduct and its consequences that have already occurred.

Consider in this connection that changes to positive law may result from two kinds of changes in circumstances. Sometimes the circumstances that change are the material conditions that made the old rule appropriate to the past, such as revenue needs in peacetime versus wartime. Other times the circumstances that change are legislative judgments about the appropriate rules for what are essentially the same set of material conditions, such as whether it is a good idea to subsidize state operations through the federal tax system. As discussed below, these differing types of changes may give rise to different answers to the question of whether there ought to be transition *relief* when the law changes, but what they share is highly relevant to the question of nominal retroactivity. Nominal retroactivity is not a response to changed circumstances at all. It is a decision to recharacterize a past action or state of affairs in a manner inconsistent with how a prior legislature characterized it. The difference between this kind of recharacterization and a decision to subject new circumstances to a different rule, even when the new circumstances reflect past decisions, is that there never can be certitude about the future, whereas there is certitude about the past. Because it is not possible to provide certainty with regard to future states of affairs, it is not reasonable to suppose that any enacted rule will continue indefinitely, or even that “relief” will be made available no matter what. In this sense, the characterization of future circumstances that is implied in

---

<sup>124</sup> The point might be refined as follows: Certain tacit rules conceivably could be derived; identifying them is the subject of social contract theory. *See, e.g.*, JOHN RAWLS, A THEORY OF JUSTICE (1971). These rules, however, are marked by their supposed universality for any rational agent, or at least for a large subset of possible rational agents, and by their highly general nature. It is difficult to see how they ever would include an authorization for a legislature to override a previous legislature.

<sup>125</sup> Part II.B.3.

a forward-looking rule, such as the exclusion of interest from gross income on municipal bonds, is always provisional: Because circumstances can change, the conditions that make the exclusion appropriate may not obtain in the future.

Another possible objection to the argument made here is that only a transition norm of nominal retroactivity would call government legitimacy into question, and nominal retroactivity is a relative rarity – at least as regards positive law. But, as has been exhaustively discussed, the new view is predicated on the idea that the difference between nominally retroactive and nominally prospective legal change is largely illusory.<sup>126</sup> The distinction is said to be material only in the sense that nominally retroactive changes are likely to have a greater effect than nominally prospective changes on the magnitude of the legal change.<sup>127</sup> Either of two possible conclusions follow. One is that there is, in fact, a significant distinction between nominal prospectivity and nominal retroactivity that is not captured in the difference between the effect of either on the market value of investments. The other would be that even a norm of nominal prospectivity raises the stability question, since certain nominally prospective changes can greatly alter the value of pre-change investments. The former would demand a reconsideration of the decision to differentiate nominal prospectivity from nominal retroactivity on purely quantitative grounds, while the latter seems to be false: Nominal prospectivity does not raise the same difficulties that nominal retroactivity does, as evidenced by the fact that the strength of the ANR norm is not matched by any comparable norm for purely prospective legal change.<sup>128</sup>

---

<sup>126</sup> Kaplow, at 515; Levmore, *Retroactive Taxation*, at 266-79; Stark, at 154 (“Given individuals’ forward-looking behavior, the difference between prospective laws and retroactive ones is really just a matter of degree, not of kind.” (summarizing Graetz’s view)).

<sup>127</sup> Graetz, *Retroactivity Reconsidered*, at 1826.

<sup>128</sup> Levmore’s 1993 article is illustrative of the problems identified in the text above. It sets out an extended analysis of tax law retroactivity from the new view perspective, examining the prospects for and problems with a regime of occasional nominal retroactivity from the perspective of actors’ market incentives. Levmore does not examine whether a retroactivity regime would call into question the legal regime in which it is possible to rely on insurance markets in the first place. *See id.*, at 277-78. In this respect, Levmore, like others writing in the new view literature, seems to take law as a naturalized given rather than as an institution that depends for its existence, in part, on certain transition norms.

Kaplow seems similarly unconcerned about the extent to which transition norms may affect critical background conditions. For example, he states that “the ubiquity of transition concerns uncovers the inconsistency of condemning retroactivity as traditionally construed, while ignoring the broader and more pervasive retroactive effects just described on the ground that they are sufficiently benign to be given little weight.” Kaplow, *Economic Analysis*, at 518-19 (internal fn. omitted). As evidence for this proposition he quotes as exemplary the following statement from Joseph Story’s *Commentaries on the Constitution*: “Retrospective laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of the social compact.” 2 J. STORY, COMMENTARIES ON THE

From the perspective of the private investor, the significance of the ANR norm lies not simply in the fact that it prevents application of new rules to investments already made. It is that it gives expression in a particularly vivid manner to the idea that, as a general matter, law promulgated by an elected legislature is the means by which individuals subject to it regulate their actions in light of their circumstances and one another's conduct.<sup>129</sup> If law were the means by which an independently authorized or naturally existing sovereign implemented its commands, then neither instantaneously promulgated nor retroactively extended legislation would raise an issue apart from the question of the incentive effects on investors.<sup>130</sup> Where law is a means of self-government, the strict separation between the law-giver and the persons subject to law does not hold, and the idea that laws need not be guides to conduct that, in a certain sense, investors apply to themselves gives way.

## 2. Action date relief – treating new interpretations as new law

If the hypothetical extension of the rule for judicial interpretations to positive enactments illustrates the failure of the new view to appreciate the limitations that apply to the choice of transition norms, the inflexibility of the new view emerges upon consideration of the converse case: extension of the default norm of nominal prospectivity to judicial decisions that announce new interpretations of existing rules.<sup>131</sup> The difficulty here is that it becomes impossible under the new view to make out a reason for a different transition norm for a different method of propounding a new rule, because, as previously discussed, the method by which the government adopts a new rule is

---

CONSTITUTION § 1398 (5<sup>th</sup> ed. 1891), *quoted and cited in* Kaplow, *Economic Analysis*, at 518 n.16. Kaplow offers no discussion of why retroactivity might undermine the social compact. *See also* Logue, *Opportunistic Retroactivity*, at 1145-48 (discussing problems with the government's failure to keep its contractual commitments solely in terms of the added cost to incentive provisions that such a failure creates).

<sup>129</sup> *See* Munzer, at 391 (“A retroactive law makes it difficult or impossible to act with knowledge of the applicable law. The strongest way of putting this is to say that if a law is retroactive, it logically cannot guide behavior with respect to the act whose legal status is altered.”).

<sup>130</sup> It should be noted, however, that if the law had this character, it is not clear that any incentive problem would be created. If government's authority is predicated on its wisdom, then subjects would simply follow its commands. Rapidly changes in the law would not supply a basis for reticence about taking advantage of preferences because the changes would be correct.

<sup>131</sup> For purposes of the discussion, I assume that parties would continue to have an incentive to bring suit even where relief depended upon adoption of a novel and therefore nominally prospective interpretation of existing law, since the question here relates to the different matter of the larger consequences of a prospectivity norm. The principle could be implemented by providing for a government payment to the aggrieved party where the court found for the plaintiff on the basis of a novel interpretation of the law.

considered to be a formal or arbitrary feature of the rule – at least where considerations of institutional competence or impartiality are not in play.

In conventional or “old view” terms, the basis for retroactivity of judicial relief is, of course, that the pronouncement of a new interpretation merely states what the law already was,<sup>132</sup> or perhaps more realistically states the “best” or “appropriate” interpretation among a small number of candidates. To be sure, in some circumstances that notion is a fiction,<sup>133</sup> but the norm, and certainly the justification commonly offered for the norm, conforms to the idea.<sup>134</sup> Under the new view, the rule for judicial “new rules” therefore presents a puzzle: Why have retroactivity for these rules if a norm of nominal prospectivity should operate for positive law? If the same general considerations apply regardless of the form in which a legal transition occurs, it becomes difficult to explain different defaults for different types of government action. While some new view scholars have noted that different norms for different types of cases may be appropriate, they have generally defended the idea with reference to the substance of the underlying rule, not the form in which the new rule is promulgated. For example, as previously mentioned, Kaplow supports a norm of nominal prospectivity without transition relief for transitions that respond to changed circumstances, but he argues for a norm of retroactive application of new rules “when the justification for a reform suggests that the prior activity was undesirable.”<sup>135</sup> Needless to say, both a court and a legislature (as well as an administrative agency or any other governmental policy-making entity) can be confronted with either type of case.

The case for retroactivity of judicial interpretation, however, has nothing to do with whether the prior activity was undesirable. It has to do with the fact that judicial action purports to be a statement of what the law is, even though on occasion the statement may reflect a court’s view of what it ought to be.<sup>136</sup> At all events, the

---

<sup>132</sup> Munzer, at 375; SHAVIRO, at 112.

<sup>133</sup> A salient example is the California Supreme Court’s adoption of a strict liability standard for product defects. *Greenman v. Yuba Power Products, Inc.* 59 Cal. 2d 57 (1963).

<sup>134</sup> See SHAVIRO, at 112 (“To some extent, the nominally retroactive application of judicial decisions is logically inherent in what we call the judicial function.”). It should be noted that the paradigmatic announcement of a new rule that is inconsistent with the prior rule announced by the same court is a rarity in judicial decisions, as evidenced by the strength of the doctrine of *stare decisis*. More commonly a judicial new rule arises when a higher court resolves a conflict among lower courts, resolves a matter of first impression, or disagrees on a matter of first impression with a lower court. SHAVIRO, at 112-15.

<sup>135</sup> Kaplow, *Economic Analysis*, at 551. See also Logue, *Opportunistic Retroactivity*, at 1154-58 (distinguishing the case for transition relief on the basis of whether Congress has acted opportunistically or not, and on the basis of the least-cost avoider in the case of transitions motivated by the discovery of new information).

<sup>136</sup> See, e.g., Scott J. Shapiro, “The ‘Hart-Dworkin’ Debate: A Short Guide for the Perplexed,” Michigan Law School Public Law and Legal Theory Working Paper Series No. 77, at

uncertainty that adjudication resolves is very different from legislative uncertainty. Uncertainty about the content of law is a feature of any legal system for the simple reason that no law can contain a full specification of all the cases to which it applies.<sup>137</sup> That is why, as contrasted with legislation, adjudication typically resolves a legal question in favor of one among a very small number of candidate interpretations. Each of these candidate interpretations is typically known to the litigants not only before trial but, in the ordinary case, at the time at which they engage in the relevant conduct. Hence it is in this setting, much more than in the legislative setting, that the case for retroactivity is strongest. Where the legal risk is quantifiable beforehand, it is much easier to insure against it. The fact of limited possible interpretive outcomes also places much less strain on concerns about rule of law than would the possibility of open-ended retroactive application of new law, which can in principle have any content. In short, because the new transitions literature disregards the different nature of the uncertainty that legislation and adjudication resolve, the distinct justification for retroactive application of judicial interpretation becomes unintelligible for the new view. That justification is ultimately the same one that applies to rules more generally, which is that parties nominally subject to them should, in fact, be subject to them, even if there is by necessity some uncertainty in their content in borderline cases.<sup>138</sup>

### 3. The conventional nature of legal regimes

Both of the problems of the new view literature described in the preceding sections of this subpart point to a deeper one, which is a fundamental failure to appreciate the institutional nature of law and therefore the institutional context in which the transitions question arises in the first place. On one hand, as artificial institutions, legal regimes are instantiations of convention or agreement, and agreement is not subject to natural constraints. This absence from constraint means that legal transitions can occur at times different from their announcement dates, and indeed at times that depart from the announcement dates in ways that vary depending on the conventional settings in which the transition arises. While scholars writing from a new view perspective have of course entertained the possibility of a norm for legal transitions that incorporates some amount of relief and some amount of retroactivity, the literature has generally settled on a norm of enactment date effectiveness because it cannot identify the institutional reasons that would support a different date – either prospective effectiveness (or some transition relief

---

41-52 (developing a positivist account of disagreement over theoretical legal principles), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=968657](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=968657) (last visited on Aug. 12, 2008).

<sup>137</sup> *Id.*, at 16.

<sup>138</sup> *Marbury v. Madison*, 5 U.S. 137, 177 (1803) (“It is emphatically the province and duty of the judicial department to say what the law is.”), is probably the most famous articulation of this principle in the constitutional law context. *See also* 1 BLACKSTONE, COMMENTARIES 69 (15th ed. 1809) (stating that the court’s duty was not to “pronounce a new law, but to maintain and expound the old one.”). [confirm].

variant thereof) for reliance-based reasons when they might apply, or retroactive effectiveness for nominal transitions that in fact further the principle or purpose of an already enacted rule. In short, the literature is unable to comprehend the flexibility that arises from different institutional settings, rather than from different substantive settings, such as whether the underlying conduct was good or bad, or from the varying propensities of different actors to be subject to non-socially optimizing conduct because of capture, principal-agent problems and the like.

On the other hand, as artificial institutions of a certain sort, legal regimes cannot be instantiations of just any convention, even if the natural facts on the ground might support a particular transition rule in a particular case. They must be instantiations of conventions that are consistent with the terms on which legal regimes are established. By naturalizing the circumstances within which legal transitions occur – such as, for example, by assuming the existence of well functioning markets no matter what the legal regime – the transitions literature fails to appreciate the relationship between transition norms and the set of legal institutions and relationships that depend, in part, on those norms and that provide the framework within which the conventional, including markets generally and insurance markets in particular, appears natural. As a result, the literature fails to appreciate what is at stake in adopting one set of norms rather than another in different transition settings; it is able to comprehend the differences among possible norms only in terms of the impact on private expectations under the assumption that private expectations will not differ depending upon which governmental actor initiates the legal transition.

## V. Reliance and reasonable expectations

None of the observations made in the preceding part imply that the actual policy recommendations the recent transitions literature has reached are incorrect. Nor, conversely, does the fact that the law occasionally has been applied in ways inconsistent with principles that support political stability refute the observations made above, because the question is what an appropriate transition norm should be, not what consequences follow from the fact that the government occasionally has deviated from one or another norm. What the observations do mean, however, is that any particular transition norm must be evaluated with a view to the impact it will have both on “investor” incentives and on the conditions that permit investors to react to incentives effectively. When the new view literature is evaluated according to these criteria, it turns out that its recommendations tend to be either uncontroversial – that is, not particularly different from those of the “old view” – or highly questionable. In the end, the recent transitions literature has little to say that is both new and true.<sup>139</sup>

---

<sup>139</sup> There appears to be some recognition of this claim in the literature itself. For example, in his review of Shaviro’s book on legal transitions, Logue notes that the “concrete policy payoff” of Shaviro’s extended argument is ultimately disappointing. Kyle D. Logue, *If Taxpayers Can’t Be Fooled, Maybe Congress Can: A Public Choice Perspective on the Tax Transition Debate*, 67 U. CHI. L. REV. 1507, 1509 (2000) (internal quotation marks omitted).

In this part I develop these claims through an examination of the case for transition relief under nominally prospective legal change. Prospective change is the focus here because I have already argued that the transition literature's arguments for nominally retroactive rules are unpersuasive. The first subpart reviews the charge that reliance-based arguments for transition relief are circular. The conventional argument for reliance to which this charge has been raised generally has been made in two distinct settings, a fact typically unnoticed in the recent transitions literature: to oppose the nominal retroactivity of positive law, and to advocate transition relief for a limited class of nominally prospective changes to the law.<sup>140</sup> Although different justifications for the reliance argument apply in the two settings, the blanket criticism offered under the new view has tended to collapse the cases because new view scholars reject the idea that there is a meaningful distinction between nominal retroactivity and nominal prospectivity that has retroactive effect. The discussion in the previous part has indicated why the distinction is meaningful and why reliance on the notion that legal transitions will not generally be nominally retroactive is reasonable.

The second subpart demonstrates that the case for reliance as a basis for certain forms of relief from nominally prospective legal change is perfectly sensible as well. As a general matter, many types of legal rules can be analogized to promises of one sort or another, while others cannot. Where the original rule has a quasi-promissory character, and where the circumstances that give rise to a change to the rule reflect a change in policy rather than a change in underlying circumstances, the case for transition relief is strongest. Where one or both of these factors is absent, the case is weaker or non-existent.

#### **A. The new view critique of reliance**

As previously discussed, under the new view, "transition relief" should generally be denied because it creates an undesirable government externality.<sup>141</sup> The asserted

---

Similarly, Barbara Fried notes that the philosophical literature grounded in "luck egalitarianism," which is not significantly distinguishable in orientation from the "old view," has reached more or less the same set of policy recommendations as the new view. Barbara Fried, *Ex Ante/Ex Post*, 13 J. CONTEMP. LEG. ISSUES 123, 124 (2003) ("The organizing premise of luck egalitarianism . . . that a just state would equalize the effects of brute luck on individual endowments, but leave individuals to bear the consequences (good and bad) of their choices . . . has led luck egalitarians to more or less the same conclusion that 'rational expectations' economists have reached on welfarist grounds . . .").

<sup>140</sup> [CITES.]

<sup>141</sup> Kaplow, *Economic Analysis*, at 531. See also Graetz, *Retroactivity*, at 77-78; Graetz *Retroactivity Revisited*, at 1823-24; and Shaviro, at 2-3, for further discussion of this issue. Kaplow also considers and rejects other arguments that might support transition relief. These include forcing the government to internalize harms, more fairly distributing the burdens and benefits of government, and maintaining horizontal equity. Kaplow *Conceptual Framework*, at 170. I do not discuss them here.

parallel to market-based uncertainty is said to justify this principle, while reliance and reasonable expectations arguments are said not to weigh in the other direction, because reliance and reasonable expectations are second-order principles that depend upon underlying practices.<sup>142</sup> I have argued that the positive part of the argument – the analogy of legal change to market-based changes – fails because various aspects of the legal regime on which markets depend cannot be assumed to persist under certain transition norms, such as a norm of extensive retroactivity to positive law.<sup>143</sup> More generally, I have suggested that the positive case for a norm of no relief, to the extent it rests on the analogy, is conceptually flawed because it presupposes the transition rule it purports to justify.<sup>144</sup>

In this section, I focus on the charge of circularity as applied to the reliance norm.<sup>145</sup> As contrasted with the positive case that, for example, Kaplow and Graetz make for no transition relief, this negative part of the argument is perfectly valid. One cannot justify transition relief on the basis of reasonable reliance or rational expectations without justifying the practice upon which the expectations are based, for if the practice were different then rational expectations and reasonable reliance would differ too.<sup>146</sup> Therefore one would need to justify the underlying practice in order to defend the reliance principle.

The important point about this criticism is that it is in no way inconsistent with the old view. Stated somewhat differently, a proponent of the old view is not committed to extensive relief for nominally prospective changes to positive law as a general matter, or even to the idea that transition relief should operate as a default for such transitions. These conclusions should not be surprising, since the validity of the circularity charge

---

<sup>142</sup> See Part II.

<sup>143</sup> For purposes of this discussion, I bracket the point made earlier that Kaplow does not articulate a well-defined concept of transition relief because the broad-based concept of legal transitions that he and other new-view theorists adopt implicitly rejects the baselines supplied by the conventional understanding and in light of which it is meaningful to speak of relief. See Part II., above.

<sup>144</sup> See Part III.A.

<sup>145</sup> See Graetz, *Retroactivity*, at 74-75; Kaplow *Conceptual Framework*, at 170. The principal exception to this view among new view scholars appears to apply to roughly the same set of transitions for which I argue the reliance view would suggest transition relief. See, e.g., Ramseyer & Nakazato, at 1162-73.; Logue, *Opportunistic Retroactivity*, at 1138-43. I discuss this class of transitions in the next subsection.

<sup>146</sup> In essence, in Kaplow's view the most that could be said about the expectations argument is that it raises the question of the proper transition to the proper transition regime. Kaplow, *Economic Analysis*, at 557-60. Kaplow notes that the questions this issue raises are distinct from those of the proper "steady state" transition policy. Since it is currently reasonable to expect transition relief, it may not be appropriate to move to another transition norm without offering second-order transition relief. *Id.*

does not depend upon anything about either the welfarist view of legal transitions or the anticipations-oriented approach. By the same token, the suggestion that the old view uncritically favors transition relief on the basis of reliance represents something of an overstatement.<sup>147</sup> Old view scholars have not typically offered free-floating reliance arguments in favor of transition relief for nominally prospective transitions. Although not always clearly articulated, the arguments for such relief (as contrasted with relief from nominally retroactive enactments) generally have applied to a relatively narrow range of enactments.

Graetz's discussion of reliance arguments in the prior literature is illustrative of the new view's tendency to group together reliance arguments made against nominal retroactivity with reliance arguments made against the failure to provide transition relief for nominally prospective transitions. Graetz quotes the following statement by Edwin S. Cohen, Assistant Secretary of the Treasury for Tax Policy during the first Nixon Administration, in support of his claim of the predominance of the old view way of thinking:<sup>148</sup>

[P]rovisions have been deliberately kept in the tax law over many years, and they constitute standing invitations for taxpayers to erect new buildings, drill for oil, or embark on programs of charitable contributions. Even if we should conclude that it would be unwise to continue some of these benefits or if we should alter some of them, it would not be appropriate to remove the preference precipitously after taxpayers have embarked on programs which they might not have adopted except for these provisions.

Graetz goes on to observe that “[a]n argument in this form, without more, ends analysis.”<sup>149</sup> But the observation, while perfectly true, is of limited relevance. Rarely have arguments for reasonable reliance been made simply on the basis that reliance alone justifies relief.

Indeed Cohen's statement is far from the clarion call for transition relief that one might presume from the excerpt quoted. As the latter part of the quotation intimates, Cohen is discussing the repeal or limitation of specific items of tax preference, not all

---

<sup>147</sup> Graetz, *Retroactivity Revisited*, at 1823 (“In short, the argument asserts that people have a right to protection merely because either they now expect such protection or they expected such protection when they entered into a transaction; their expectations allegedly create a right and their asserted rights legitimate their expectations.”); Kaplow, *Conceptual Framework*, at 170. (“[I]t is increasingly recognized that arguments based on actors’ reliance on and expectations concerning existing law are circular and otherwise deficient.”).

<sup>148</sup> Graetz, *Retroactivity*, at 74 (quoting Edwin S. Cohen, *The Administration's Interim Program of Tax Reform and Tax Relief*, 47 TAXES 325, 327 (1969)).

<sup>149</sup> *Id.*

proposed changes to the tax law, a point confirmed by other parts of his text.<sup>150</sup> In fact, in the same statement to Congress, Cohen advocates some changes to existing law that would be effective retroactive to the date he made the statement.<sup>151</sup> The reason for this limited retroactivity is that the provisions to which it applies are intended to correct unintended errors contained in or opportunities for abuse offered under prior law.<sup>152</sup> Thus, if Cohen is guilty of anything regarding the reliance argument, it is his failure to identify which of the conventional justifications for protection of reliance interests apply when Congress repeals tax preference items on the basis of new policy judgments.

A similar example is found in Kaplow's work. He states:<sup>153</sup>

One of the most commonly noted arguments against allowing private actors to bear losses resulting from changes in government policy is that they reasonably relied on preexisting law in making investment decisions. Many legal theorists, however, have long recognized the circularity of such arguments, which implicitly assume that it is reasonable to expect laws never to change . . . .

Although Kaplow goes on to observe that whether reliance is in fact appropriate will vary from case to case, he does not explore what factors are or should be relevant in the various cases. Rather he tends to discount the reasonableness of reliance altogether.<sup>154</sup>

Somewhat ironically, one reason that new view scholars may have tended to overstate the role reliance arguments play under the old view is their insistence on regarding nominally retroactive enactments and nominally prospective enactments that have retroactive effects as essentially similar. Once one has effaced the distinction

---

<sup>150</sup> Graetz omits the first word of the first sentence quoted: "These." It refers to what Cohen calls "the major tax preferences." Cohen, at 327. They include such items as accelerated depreciation deductions, tax incentives for oil exploration, and charitable contribution deductions. *Id.*

<sup>151</sup> *See, e.g., id.*, at 336 ("We believe that the distortions of income tax liability involved in [so-called ABC transactions involving mineral production payments], and increasing utilization in various extractive industries, indicate that these distortions should be terminated promptly. . . . We recommend, therefore, that this provision be enacted as promptly as possible and be effective with respect to transactions consummated, or covered by a binding contract entered into, on or after April 22, 1969 [i.e., the date Cohen delivered the statement to the House Ways and Means Committee]. The industries involved have had adequate notice that the tax treatment of production payments was under reconsideration.").

<sup>152</sup> [CITE.]

<sup>153</sup> Kaplow, *Economic Analysis*, at 522 (footnotes omitted).

<sup>154</sup> *Id.*, at 525; *see also* Kaplow, *Conceptual Framework*, at 170 ("Although commonplace in most transition settings, it is increasingly recognized that arguments based on actors' reliance on and expectations concerning existing law are circular and otherwise deficient.").

between prospective and retroactive legal change, there is not much point in distinguishing between old view discussions in which reliance is featured as a defense to nominal retroactivity from those in which it is raised as a defense to transition *relief* understood in the conventional, that is, forward-looking, sense. Indeed, many of the discussions to which the new view theorists point as examples of excessive deference to reliance arguments concern nominally retroactive statutes, not transition relief offered in the context of nominally prospective legal change.<sup>155</sup> But the old view does not efface the distinction between nominally retroactive legal change and the purportedly retroactive effects of nominally prospective legal change, for the reasons discussed previously. As a consequence, the old view's near blanket rejection of nominal retroactivity on reliance grounds is perfectly compatible with a much more limited skepticism toward reliance as a basis for transition relief.<sup>156</sup> The distinction seems simply to be lost on new view scholars.<sup>157</sup>

Indeed, and not surprisingly, the idea that reliance interests support transition relief for all nominally prospective changes to the tax law does not appear ever to have been seriously entertained by anyone, a point well recognized in the transitions literature itself. For example, changes in tax rates,<sup>158</sup> including rates on capital income, never have

---

<sup>155</sup> For example, three of the four commentaries that Kaplow cites in support of the pervasiveness of the reliance norm are expressly concerned with the validity of reliance arguments against nominally retroactive legislation. See Kaplow, *Economic Analysis*, at 522 n.26 (citing Committee on Tax Policy, Tax Section, New York State Bar Association, *Retroactivity of Tax Legislation*, 29 TAX LAW. 21, 25 (1975); Note, *Setting Effective Dates for Tax Legislation: A Rule of Prospectivity*, 84 HARV. L. REV. 436 (1970) [hereinafter Note, *Setting Effective Dates*]; Alan S. Novick & Ralph I. Petersberger, *Retroactivity in Federal Taxation: Part II*, 37 TAXES 499, 499-504 (1959)). The fourth commentary adduces reliance as a basis for compensation in the case of prospective changes to zoning laws. *Id.* (citing *Developments in the Law: Zoning*, 91 HARV. L. REV. 1427, 1494-97 (1978)). Even here, however, the author notes that the strength of the reliance argument varies with the nature of the zoning ordinance on which it is based. *Developments in the Law: Zoning*, at 1495-96. In their counterpart discussions of the old view of reliance, Graetz and Logue cite some of the same literature. See Graetz, *Retroactivity*, at 73 n.78; Logue, *Opportunistic Retroactivity*, at 1136 n. 27.

<sup>156</sup> See, e.g., Cohen.

<sup>157</sup> Graetz remarks that “[t]he evaluation of claims for transitional relief should be guided not by the existence of expectations, but rather by some independent normative vision of what people should be entitled to expect.” Graetz (1985), at 1823. The statement is true, but without more, it does not demonstrate that reliance arguments may not succeed in explaining why transition relief should be offered in certain circumstances.

<sup>158</sup> Although most ordinary income is taxed in the year earned, and hence does not raise a transition question assuming there is no nominal retroactivity to a later change in law, a long-term contract entered into under prior law would raise a transition issue. Thus, a taxpayer who entered into a multi-year contract when the applicable marginal was 25% would not be thought entitled to have that rate grandfathered if rates went to 35% before the term of the contract.

been accompanied by relief, and serious arguments for relief for such changes have not been made. Similarly, provisions designed to address arrangements that comply with the law but do not produce tax results considered appropriate often have been enacted with at least some retroactive effect.<sup>159</sup> Outside of the tax area, various changes to the legal regime routinely have substantial adverse impacts on individuals who have relied on prior law, but the idea that Congress should make extensive grandfathering relief available is not entertained. In short, the types of legal change for which reliance-based transition relief (as opposed to reliance-based relief against nominally retroactive legislation) has been argued have generally been considered changes to provisions that were thought to invite reliance for reasons other than the mere fact that they were law.

## **B. The positive case for reliance**

The preceding observations indicate that the old view proponent of some role for reliance is committed to distinguishing between the circumstances in which reliance might support some form of relief (measured against the norm of enactment date effectiveness) from those in which they would not, on the basis of underlying features of a legal order that the welfarist literature largely ignores or takes for granted. In this subpart I argue that the same considerations that support distinguishing between market-based and legal transitions support the introduction of a concern with reliance. In the end, the concern rests on an acknowledgment that whoever has authority to make a legal change of one type or another has the authority on the basis of some sort of agreement, however attenuated, with those who are subject to the new rule. To the extent that the presence or absence of transition relief bears on reasonable assumptions about the terms on which the government actor exercises political authority, reliance may or may not be appropriate.

To make this claim is not to assert that government actors are bound by promise just as private parties may be, or even that there is anything wrong with an array of possible transition “norms” for the different circumstances embraced by the same formal type of legal change.<sup>160</sup> Rather it is to highlight that private actors rationally view government legitimacy as related to government conduct, and therefore that different circumstances would support different kinds of transition relief, depending upon whether making relief available, or not, would be appropriate for a party to the quasi-agreement between the rule makers and the rule followers. Hence the question whether relief should be made available, or whether a law should be given retroactive effect, depends not just

---

<sup>159</sup> See Note, *Setting Effective Dates*, at 438-42 (noting retroactive aspects of tax legislation).

<sup>160</sup> The reliance argument is sometimes framed as resulting from a notion of quasi-contract between the government and private actors. It is better framed as resulting from a quasi-promise, both because reliance damages arise out of promissory obligations and because there is no analog to consideration in contract that runs from those subject to legal rules to those who promulgate them.

upon whether in some abstract way the law itself is “good.” It depends upon the terms, implicit or otherwise, on which the prior law was enacted and the circumstances in which it is repealed.

In order to illustrate the basis for limited claims of reliance, in this subpart I examine two cases, each involving the repeal of the municipal bond interest exclusion. (The second case, in turn, has two variations.) I assume in both cases that Congress has adopted the interest exclusion for municipal bonds because it has concluded that state activities should be subsidized by the federal government on a steady-state basis and that the exclusion is an appropriate method for doing so. The question is whether transition relief should accompany a repeal of the exclusion.

### **1. First case: change in material circumstances**

Under the old view it would seem that whether repeal of an incentive provision of this sort merits some sort of transition relief depends upon the reasons for the repeal. Suppose in the first case that Congress repeals the exclusion in response to an unforeseen change of material circumstances, such as a need to raise revenue. Under these circumstances it does not seem that transition relief should be expected, though one could imagine reasons why in any particular case it might be made available. In this setting, one could well say – and it seems for reasons well documented in the literature,<sup>161</sup> it would be preferable to say – that no transition relief should be in the offing absent significant distributional or other considerations that would make relief a good idea. The simple reason is that it remains unclear why relief should presumptively be in the offing when the conditions under which it makes sense to offer the preference no longer obtain, and there is no reason why investors ought not be charged with assuming the risk that if circumstances make the law a bad idea, they ought not be entitled to enjoy the benefits of the law.<sup>162</sup> After all, the decision to offer the preference was made, implicitly or not, on the basis that the circumstances made the preference a good idea. As argued in the preceding subpart, there is never certainty about the future, and it difficult to see why, a priori, the government rather than investors ought to absorb the costs of unexpected developments that make existing law non-optimal. Importantly, nothing about the argument requires adoption of the incentive-based approach or abandonment of fairly standard assumptions about what investors may or may not expect in terms of reliance.

### **2. Second case: change in legislative judgment**

Contrast the preceding situation to the second case, in which repeal rests upon a differing policy evaluation of essentially the same basic circumstances. Here the material circumstances that were thought to support the preference have not changed; rather Congress has reconsidered the wisdom of the initial decision to offer the preference. This case presents, in turn, two variations. The first is where the same legislative body is in

---

<sup>161</sup> [CITES.]

<sup>162</sup> See SHAVIRO, at 48; Logue, *Legal Transitions*, at 227-35.

place at all relevant times, while in the second a subsequently elected legislature initiates the transition. Under both variations, the analysis runs differently from the case in which the material circumstances change.

**(i) First variation: same elected body**

Consider the first variation, in which the same elected body both enacts and repeals the tax benefit. As a first step, note the difference between a preference that provides benefits on an immediate basis, such as the deduction for certain research and experimentation expenditures,<sup>163</sup> and a preference the benefits of which materialize over time, such as the bond interest exclusion. If the research and experimentation deduction were enacted in Year 1 and repealed prospectively in Year 2, all of the benefits expected from expenditures already made by the time of the repeal would have been realized. By contrast, a prospective, non-grandfathered repeal of the bond interest exclusion would preclude investors from reaping any of the benefits expected to be realized in the future.<sup>164</sup> Despite these different timing results, it is by now a familiar truth that on a steady-state basis the difference between these methods of providing a benefit differ in purely formal terms.<sup>165</sup> Assuming no change in law, one could offer the same benefit that the bond interest exclusion provides by permitting a deduction for the purchase price of the bond in the year of purchase and taxing all subsequent returns (principal and interest) as they are received.<sup>166</sup> Under either model, the relevant investor decision occurs in the pre-repeal period, but under the deduction-inclusion model, a prospective, non-grandfathered repeal would not preclude realization of any benefits that investors would be awaiting under the interest exclusion model. In this context, the material

---

<sup>163</sup> 26 U.S.C. § 174.

<sup>164</sup> See Part II.B.

<sup>165</sup> This result is a statement of the so-called Cary Brown Theorem. Cary Brown, *Business-Income Taxation and Investment Incentives*, in *INCOME, EMPLOYMENT, AND PUBLIC POLICY: ESSAYS IN HONOR OF ALVIN H. HANSEN* 300, 301 (1948). It depends upon certain simplifying assumptions that are not relevant to the present analysis, such as that the relevant tax rates are the same at all times and that the investor can make full, current use of the deduction for the initial investment.

Kaplow discusses this equivalence, as well as the economic equivalence between a non-grandfathered repeal of benefits that had been anticipated to accrue in the future and the same repeal coupled with taxing back benefits that had been provided as an up-front subsidy. See Kaplow *Conceptual Framework*, at 188-89; see also SHAVIRO, at 218 (noting the equivalence in the methods for the municipal bond case).

<sup>166</sup> Consider a taxpayer in the 30% tax bracket who earns \$100 and uses the after-tax proceeds to purchase a 10-year municipal bond that pays 10% annually. Under the interest exclusion regime, she pays \$30 in tax on her earnings, purchases a \$70 bond, receives \$7 annually in untaxed interest, and receives her \$70 back at term tax-free. Under the deduction regime, she pays no tax on the \$100 of earnings, purchases a \$100 bond, earns \$10 annual interest on which she pays \$3 tax, and receives her \$100 back at term, at which time she pays \$30 in tax

equivalence of the two methods under steady states, coupled with the previously made argument against the propriety of nominal retroactivity, seem to indicate that grandfathering is appropriate on repeal where Congress chooses to make the form of the preference require its persistence into future periods in order to be fully realized.

The obvious response to this argument is that it seems to prove too much, for the same could be said of the case previously described, in which repeal takes place under changed circumstances. In that setting it was suggested that Congress's decision to implement the tax benefit in the form of an interest exclusion rather than as an up-front deduction signaled that investors are at risk of no relief in the event of repeal.<sup>167</sup> The argument just offered, however, suggests that the equivalence under certain background assumptions of an up-front deduction with an exclusion over time means the same total benefits should be available on repeal in either case. It therefore seems that both claims cannot be correct. This suggestion rests upon a failure to account for the decisive difference that the different background conditions make for the two cases. It is precisely the fact that a forward-looking preference presupposes appropriate material conditions that makes a presumption of no relief when these conditions change appropriate. Where, however, there is no change in material circumstances, the forward-looking preference and the immediate preference become indistinguishable, for the risk assumed under the forward-looking preference has not materialized, and it was that risk that justified the presumption against transition relief.

One might accept that a difference between changed material circumstances and changed legislative judgments has some significance, but query why investors might not also assume the risk of no relief in the latter case when a preference is adopted on a forward-looking rather than an immediate basis. The difficulty is that if such a presumption obtained, then the enactment of a tax preference whose benefits extended to future periods would rationally be viewed as equivalent, at the front end, to Congress's saying that it does not want to provide the preference on a steady-state basis under the existing facts, for if it did it would have made the preference available as an immediate deduction. It is entirely unclear why such a signaling presumption should operate. It needlessly limits Congress's ability to offer tax benefits in the form it prefers, when Congress can limit the benefits on enactment directly, simply by sunseting the preference or by making it otherwise conditional. For although a deduction and an exclusion may be the same on a steady-state basis, they have different properties with respect to transition periods, and Congress might well prefer to plan for the possibility of changed material circumstances in designing the tax preference; removing the presumption that any forward-looking preference comes with a risk of uncompensated change even where material conditions don't change leaves that flexibility available. Consider that where a change in circumstances makes the preference a bad policy idea, having offered the exclusion is cheaper than having offered the deduction, precisely

---

<sup>167</sup> See generally Logue, *Opportunistic Retroactivity*, at 1181-94 for a discussion of methods by which Congress might bind itself to transition relief.

because the exclusion's benefits materialize later than the deduction's; the forgone revenue under the exclusion is always less than under the deduction as long as any bonds are outstanding on the repeal date. Because a rejection of the presumption of no relief when relevant circumstances have not changed does not entail rejecting the presumption when they have changed, there is no benefit to be had from adopting the presumption.

Note, further, that the availability of means by which to make relief tentative other than by having a presumption of no transition relief when the facts have not changed makes the decision not to offer transition relief in this context irrational. There is literally no relevant difference on a steady-state basis between the deduction method and the exclusion method, and given that the case under consideration involves no material change to the facts, the potential penalty of non-grandfathered repeal would indeed depend upon "mere accounting considerations"<sup>168</sup> because what obtains is, in effect, a steady state. And this equivalence indicates, in turn, that failure to provide grandfathering relief in the no-change-of-circumstances case is analytically equivalent to nominally retroactive taxation. In other words, the relevant difference between prospective repeal without relief and retroactive taxation is that one can rationally consider investors to have assumed the risk of changed material circumstances that may make current law sub-optimal, not that they have assumed the risk of a mere change of mind. The assumption of the former risk is what justifies a presumption of no relief on repeal when circumstances do change. The new transitions literature has made this point, but it has not adequately distinguished between that case and the change-of-mind case.<sup>169</sup> Where there are no changed circumstances, the difference between changes that illicitly reach back into the past and those that account for new present and future conditions disappears, because the past and the future are relevantly the same. The implication of the equivalence, however, runs in the opposite direction from that assumed by the new transitions literature: Where conditions don't change, forward-looking un-grandfathered repeal, at least of incentive provisions, is analytically equivalent to illicit nominal retroactive taxation.

## **(ii) Second variation: subsequently elected body**

Under the second variation of the case in which material circumstances have not changed, the question is whether the analysis runs differently if the repealing body differs from the enacting body. More precisely, the question is whether this difference changes the reasonableness of a presumption that investors do not run the risk of an uncompensated repeal of a tax preference where the material conditions supporting its prior enactment have not changed. The analysis under the assumption that the same elected legislature enacts the repeal indicated that failure to offer relief was not rational, because there is no advantage to be gained from the presumption that relief would not be

---

<sup>168</sup> See SHAVIRO, at 106 (using the quoted language to describe the definition of nominal retroactivity).

<sup>169</sup> See, e.g., materials cited in note \_\_\_, above.

forthcoming. A significant difference does exist, however, between that case and the case in which a new legislature repeals the preference. It is to be found in the parallelism between the latter situation and nominally retroactive positive law. The principal objection to such law, it will be recalled,<sup>170</sup> was that it supplanted the elected legislature with a different, and unauthorized, legislative body. The analogous problem arises in the present case. Where the previously enacted tax preference materializes during future legislative periods, a requirement of relief on repeal (where material circumstances have not changed) threatens to supplant the current legislature with the past one. In the extreme, the present legislature would be precluded from doing anything at all in the absence of a change in material circumstances, if offering relief under prior law required its extension sufficiently far into the future.<sup>171</sup>

The same considerations also indicate that the rationality objection to the presumption of no relief in the same-legislature case does not apply here. The rationality objection rests on the assumption that a rational legislature, though it may change its mind, makes provision for doing so *ex ante*, when it enacts a provision. Under that assumption, a legislature rationally signals a decision to make preferences tentatively available under steady-state conditions expressly, by enacting a provision for a limited period of time, rather than by entertaining a presumption of no relief on repeal. Once the assumption is abandoned that the same legislature that enacts the provision repeals it, no inference about the course of future legislative conduct follows from the enactment of a relief provision in one form rather than another. Accordingly, no inconsistency or irrationality automatically results from a failure to provide relief on repeal of a forward-looking tax preference where material conditions have not changed.

By the same token, the problem of potentially binding future legislatures does not point to an automatic presumption of no relief where the repealing legislature differs from the enacting one, but rather to the need for a balancing of considerations. On one hand, prior legislatures ought not be considered to bind future legislatures on matters of policy judgment. On the other hand, the same considerations of flexibility operate in this setting as in the same-legislature setting. Since investors know that legislatures change periodically, the same questionable incentives would be created if all bets were automatically off with every election. At the other extreme, an obvious effort to lock in changes in law by enacting forward-looking reforms that necessarily materialize over long periods of time ought not be respected by a future legislature that wishes to pursue

---

<sup>170</sup> See Part III.B.

<sup>171</sup> Thus, one could imagine a case in which a late-term Congress passes a suite of relief provisions all of which materialize over ten or more years, and where the reason for passing the provisions in this form was to lock in current legislative judgments. This example has a parallel in the case of executive action, where an executive about to leave office issues or finalizes a large number of orders and regulations to entrench its policy preferences. See Nina A. Mendelson, *Agency Burrowing: Entrenching Policies and Personnel Before a New President Arrives*, 78 N.Y.U. L. REV. 557 (2003).

different priorities or takes a different view of the effectiveness of prior policies. Hence one would expect to find a variety of outcomes in this setting, depending upon the particular circumstances under which the preference was enacted.

A final point is in order here, and it illuminates one reason that no clear transition norms have in fact emerged, and why they are unlikely to. In this section I have assumed that one can divide cases according to whether relevant material circumstances have changed or not. In practice, the classification of actual cases is likely to be contested because circumstances are constantly changing, and it will frequently be an open question whether those that have changed are material to a change in law. Wholly apart from concerns of public choice – paying off constituencies, log-rolling and the like – the question of relief is contestable simply because of the difficulties in classifying cases. Hence one would expect to see what one does see in the transition context: a variety of transition rules for seemingly similar cases.

## V. Conclusion

For the most part, the new transitions literature has little to say that is both new and true. The principal reason for its failing is that it does not pay heed to the specific conditions under which legal transitions occur. These conditions are importantly conventional, and because they are conventional, the preconditions to the conventions must be satisfied if the conditions are to obtain. In something of an irony, the analogy the new transition literature uses to justify a particular set of norms holds only because these conventionally established conditions obtain and thereby appear natural, but the conditions themselves would not obtain if the rules the new transitions literature offers for many cases became transition norms.

The considerations developed here also suggest that if the authority of the lawmaker did not depend for the most part on the convention that the lawmaker expresses the will of an electorate, most of the difficulties described in this article would disappear. In that case, transition norms would not affect the conditions that make possible both markets and, therefore, the same kinds of response to legal transitions that are appropriate to market-based transitions. The connection between political and legal authority and the will of the individuals subject to law, however, is more than incidental to the legal regime. The connection means that transition norms are both more limited and more flexible than the recent transitions literature has recognized. They are more limited because they must respect the idea that the electorate is self-governing. Nominal retroactivity, as well as nominal prospectivity in certain circumstances, are inconsistent with this idea. Transition norms are more flexible because they may vary according to the type of legal transition that different institutions, based upon different conventions, engage in.

In one sense, these criticisms can be traced back to a fundamental tenet of the new transitions literature, articulated first by Graetz,<sup>172</sup> developed by Kaplow,<sup>173</sup> and given

---

<sup>172</sup> Graetz, *Retroactivity*, at 49.

perhaps its most comprehensive explication by Shaviro.<sup>174</sup> This is the idea that new rules have a retroactive effect when they have an impact on the future consequences of decisions made prior to the adoption of the rule. The idea that such transitions “reach back into the past,” in Shaviro’s formulation,<sup>175</sup> implies that one cannot meaningfully distinguish between legal transitions that apply by their terms to completed conduct and those that apply to the present and future consequences of completed conduct – conduct that projects itself into, and assumes the risks of, future developments. It is on the basis of this view that the transitions literature downplays, if it does not dismiss, the distinction between nominal retroactivity and nominal prospectivity that has retroactive effect. The considerations developed in this article, however, explain why it is sensible to draw a distinction in kind between forward-looking reforms and nominally retroactive ones, and why one might want to reserve the term *retroactive* for the latter as well as, perhaps, for future consequences of past actions where the distinction between past and future is irrelevant. Future consequences always depend upon future conditions, whereas past consequences and conduct depend upon nothing; they are complete. It is often appropriate to impute to investors an assumption of the risk that the future will differ from the past, but not that the past does not turn out to be what it was.

---

<sup>173</sup> Kaplow, *Economic Analysis*, at 515.

<sup>174</sup> SHAVIRO, at 26.

<sup>175</sup> *Id.*