An Essay on Due Process and the Endowment Effect

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INTRODUCTION

Charles Koch had a career-long commitment to administrative decisionmaking. Influenced by his five years at the Federal Trade Commission (FTC), Charles did creative work on the adjudication process and the role of the Administrative Law Judge (ALJ). He was a key part of the team assembled by the Administrative Conference of the United States (ACUS) under my direction that broadly studied the role of the ALJ and administrative adjudication process. So, in Charles’s honor and memory, I will try to solve an old administrative due process puzzle: why are those receiving various kinds of government benefits favored procedurally over those seeking them?

This inquiry begins, for me at least, with Goldberg v. Kelly, where the Court, under the Due Process Clause, granted full adversary procedures to those receiving welfare benefits before those benefits could be terminated (so called pretermination review). In doing so, and without saying so, the Court basically traded off the interests of those waiting to receive welfare benefits for the interests of those already on the rolls. Because the New York State welfare system had to ration decision resources after Goldberg, the State sought to reduce the number of erroneous grant hearings by making it harder to get on the rolls. This process shift further delayed the claims of deserving

* Chairman, Administrative Conference of the United States; President Emeritus, The College of William & Mary. This Article expresses opinions that should not be attributed to the Conference or the federal government.


4 Id. at 264–65.

5 Id. at 279 (Black, J., dissenting).

6 See Richard A. Epstein, No New Property, 56 BROOK. L. REV. 747, 773 (1990) (“[A tactical move] was to tighten up and slow down the initial eligibility determination process.” (quoting J. MASHAW, DUE PROCESS IN THE ADMINISTRATIVE STATE 34–35 (1995))). The agency went from what had been a largely self-certified application process to one where extensive
applicants, delay is not the basis for a legal objection.7 There is, of course, no civil due process right to a speedy benefits determination, as there is a Sixth Amendment right to a speedy trial.8 It has always been difficult for me to accept why the law, without so much as considering the question, should favor the interests of those already on the rolls (even erroneously) over those seeking to get on the rolls (many of whom are eligible for and deserving of benefits).

I raised this issue at another William & Mary Symposium twenty-four years ago in honor of the creator of the “new property,” Charles Reich.9 The “new property” idea transformed legal analysis by expanding traditional property concepts to include government benefits (and public employment, licenses, etc.).10 This expansion of the property dimension of the Due Process Clause triggered new procedural protections.11 In the course of that Symposium, I urged Reich to acknowledge that his full procedural rights for beneficiaries of government benefits could have a perverse effect—by working to the disadvantage of those who have not yet received them.12 But he would not bite.13 Reich responded with an analogy to government beneficiaries as travelers on an airplane flight: to be entitled to “new property,” you had to be on the plane, not standing in line waiting to check in.14 So while my Goldberg critique failed to impress that Charles, this seems an appropriate time to revisit the question (armed with new evidence, of course). I feel sure that our Charles, who attended the Reich Symposium, would enjoy a reprise of this old due process conundrum.

I. THE ENDOWMENT EFFECT

At the time of the Reich Symposium, behavioral economics had not yet penetrated legal thinking (or at least this legal thinker). Of course, some understood the issue without the aid of new economic thinking. For example, the ever prescient Henry Friendly observed right after Goldberg: “[T]here is a human difference between losing what one has and not getting what one wants.”15 It should come as no surprise that Judge documentation was required. See Joel F. Handler, Controlling Official Behavior in Welfare Administration, 54 CAL. L. REV. 479, 492–500 (1966).

7 See Goldberg, 397 U.S. at 279 (Black, J., dissenting).
8 See Barker v. Wingo, 407 U.S. 514, 515 (1972) (acknowledging the right to a speedy trial under the Sixth Amendment).
9 See Paul R. Verkuil, Revisiting the New Property After Twenty-Five Years, 31 WM. & MARY L. REV. 365 (1990). The Symposium itself celebrated the twenty-fifth anniversary of The New Property, which makes that path-breaking article almost fifty years old today.
11 Id. at 751–52; see also Goldberg, 397 U.S. at 262 n.8 (citing Reich for the proposition that welfare benefits may be more properly regarded as property).
12 See Verkuil, supra note 9, at 365–67.
13 Id. at 365 (“After listening to and reading Charles Reich’s paper, it is safe to say that one thing has not changed. Professor Reich remains an unreconstructed Reichian.”).
14 Id. at 365–66.
Friendly, who decided so many major administrative-law cases in his time, would get there early on this issue, while I had to wait for behavioral scientists to lead the way.

The endowment effect grows out of the “status quo bias” of behavioral economics. The theory posits that people value what they have more than what they may gain. It has been applied to legal settings, such as contract remedies (under willingness to pay theories). The endowment effect provides analogies readily applicable to public benefit settings. Danny Kahneman, the co-father (with Amos Tversky) of behavioral economics, in his recent work, Thinking, Fast and Slow, calls the concept of “loss aversion” (which creates the endowment effect) the greatest contribution of psychology to behavioral economics. Professor Kahneman concludes that “[i]f people who lose suffer more than people who merely fail to gain, they may also deserve more protection from the law.”

This insight provides the conceptual basis for the Goldberg result, which I found lacking at the time. And nine years after Goldberg, the rationale was explicitly adopted by the Court in connection with the due process differences between parole applications and revocations. In Greenholtz v. Inmates of the Nebraska Penal and Correctional Complex, Chief Justice Burger stated: “There is a crucial distinction between being deprived of a liberty one has, as in parole, and being denied a conditional liberty that one desires.” The loss-aversion effect behind the Chief Justice’s thinking led the Court to deny additional adversary procedures (cross-examination, discovery, etc.) at the

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17 In personal decisions, the status quo bias makes it difficult to accept change. In public settings, the “bias” makes it difficult to alter legislative or regulatory actions. See Russell Korobkin, The Endowment Effect and Legal Analysis, 97 Nw. U. L. Rev. 1227, 1266 (2003). See generally Daniel Kahneman et al., Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias, 5 J. Econ. Persp. 193 (1991) (discussing the endowment effect and status quo biases and their relationship with loss aversion).
18 The question of how to measure contract damages under willingness to pay/willingness to accept cost theories has been explored in many cases. See, e.g., Mercado v. Ahmed, 947 F.2d 863, 869–71 (7th Cir. 1992); see also O Centro Espirita Beneficiente Uniao Do Vegetal v. Ashcroft, 389 F.3d 973 (10th Cir. 2004) (en banc). Judge McConnell stated: Notwithstanding the tendency of those trained in economics to view opportunity costs as equivalent to actual expenditures, modern social science research has confirmed the reality of “loss aversion” (the tendency to attach greater value to losses than to foregone gains of equal amount) and the closely related “endowment effect” (the tendency to value already possessed goods more than prospective acquisitions).
19 Id. at 1016 (McConnell, J., concurring).
20 Daniel Kahneman, Thinking, Fast and Slow (2011).
21 Id. at 300.
23 Id. at 9. Judge Friendly was cited by the Court. Id. at 10. See supra note 15 and accompanying text.
parole application stage. The Greenholtz case, however, did nothing to restrict the minimal hearing procedures—including a statement of reasons—that were already in place. So the question for the Court was whether more process was due, not whether any process was due.

II. THE ENDOWMENT EFFECT AND APPLICATIONS FOR BENEFITS

Let us accept then that the endowment effect can be incorporated into due process cases dealing with applications for benefits in ways that limit procedural protections. But what is its reach? Consider the difference, say, between applying to a state school, like The College of William & Mary, and being expelled from it. Traditionally, the former status reduces to zero the degree to which due process property rights attach. However, the endowment effect does not go that far. In endowment effect terms, the applicant has only an opportunity cost and not, like the expelled student, an out of pocket cost. But an opportunity cost is still a cost that must be considered. The legal conclusion, that rejected applicants have a “unilateral expectation” or “mere expectancy,” is a threshold determination that eliminates the need for procedures. The loss-aversion idea vindicates differential due process protections, but it does not justify the opposite—no process at all. An opportunity cost may be an expectancy (i.e., the value of the next best opportunity), but it should still be capable of crossing the due process threshold.

Of course, applicants may use other legal theories to gain procedural protections. Sometimes the need for process can be found in cases initiated under the Equal Protection Clause. The university affirmative action cases encompass just such a setting. In Fisher v. University of Texas at Austin, the Supreme Court remanded to the court of appeals the question whether a racial classification survives strict scrutiny under Grutter v. Bollinger. On remand, the case may ultimately present situations where equal protection rights call forth process limitations on admissions decisions. In fact, the Fifth Circuit’s initial decision in Fisher, which upheld the University of Texas’s affirmative action program under the Grutter case, contained a concurrence which noted that

25 Id. at 5, 22, 35 n.17.
26 See, e.g., Kapps v. Wing, 404 F.3d 105, 113 (2d Cir. 2005) (finding that a “unilateral expectation” is not a property interest (citation omitted)).
27 See Korobkin, supra note 17, at 1250–51.
29 Id.
30 133 S. Ct. 2411 (2013). Justice Kennedy’s opinion for the majority expressly rejected the good faith standard that the Fifth Circuit had applied to admissions officers under Grutter. Id. at 2415.
31 539 U.S. 306 (2003); see Fisher, 133 S. Ct. at 2415.
"Grutter rewards admissions programs that remain opaque" and lamented that "courts are enjoined to take universities at their word." Should the district court hold a trial on the strict scrutiny issue on remand, the Due Process Clause could very well intertwine with the Equal Protection Clause in this way. Applicants will want to know not only what standard admissions officers applied, but how they actually make "holistic review" decisions. Since the standard practice when applicants are denied admission to state universities is for admissions officers not to provide any reasons, answers to the "how" questions are often unknowable. Those decision-makers may ultimately have to provide reasons to ensure that no impermissible considerations underlay a decision. The problem of exposing illegitimate motivation, which has a long history, could well be invoked in this setting, or, if not, then in a subsequent as-applied challenge.

Even in nonsubstantive right situations, several cases reject the endowment effect on applications for benefits. For example, in Cushman v. Shinseki, the Federal Circuit found a due process entitlement in an applicant for veterans’ benefits. It could be that veterans are a special class whose property rights matured when they joined the military, unlike members of the public who apply for welfare or disability benefits with no prior connection to the benefit system. Still, the Cushman court called this a case of first impression on an issue that the Supreme Court has not directly ruled upon. If so, the movement continues to be in the direction of due process.

Other cases also endorse the notion of broader due process rights for applicants for benefits. In Perdue v. Gargano, for example, applicants for Medicaid, Food Stamp, and the Temporary Assistance to Needy Families (TANF) program benefits raised due process challenges to the adequacy of the State’s reasons for denying benefits. The Supreme Court of Indiana, reversing the lower court, found the reasons for denials inadequate under Goldberg and several decisions of the Seventh Circuit. The case

32 Fisher v. Univ. of Tex. at Austin, 631 F.3d 213, 253, 263 (5th Cir. 2011) (Garza, J., concurring).
33 Id. at 251.
34 Compare JOHN HART ELY, DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW 136–45 (1980) (discussing the difficulty in determining whether an illegitimate motivation influences a decision), with Yick Wo v. Hopkins, 118 U.S. 356, 374 (1886) (holding that a city ordinance, neutral on its face, had a discriminatory impact).
35 576 F.3d 1290 (Fed. Cir. 2009). This case was later questioned in Edwards v. Shinseki, 582 F.3d 1351, 1356–58 (Fed. Cir. 2009) (Rader, J., concurring). See also Nat’l Ass’n of Radiation Survivors v. Derwinski, 994 F.2d 583, 588 n.7 (9th Cir. 1992) (reaching the same result).
36 Cushman, 576 F.3d at 1298.
37 See, e.g., Banks v. Block, 700 F.2d 292, 298 (6th Cir. 1983) (holding that no due process rights are accorded to an applicant for food stamps).
38 See Cushman, 576 F.3d at 1292.
39 964 N.E.2d 825 (Ind. 2012).
40 Id. at 828–29.
41 Perdue v. Murphy, 938 N.E.2d 766 (Ind. App. 2010).
42 Perdue, 964 N.E.2d at 834–35.
equates, for due process purposes, applicants for benefits with those already receiving
them,\(^{43}\) and it does so under standards set by Goldberg, as well as Mathews v. Eldridge.\(^{44}\) The court’s conclusion is that notice of the determination of eligibility
for public welfare programs must be individualized and provide an explanation for the
denial of benefits.\(^{45}\) By explicating the notice requirement for applicants receiving
public benefits, the Indiana Supreme Court launched a direct challenge to the “mere
expectancy” cases.

These cases show that courts can challenge traditional due process theory about
those seeking government benefits without denying the endowment effect itself. The
Perdue court’s close look at the information gap many applicants face presents an inter-
esting question: how might it apply to applicants for admissions to Indiana state univer-
sities whom I assume are currently denied admission without any explanation other
than a terse email or a “thin” envelope? Requiring admissions officials to give reasons
for denial would surely upset established academic processes, but it might provide im-
portant information at low institutional cost. Shorthand explanations (deficiencies in
rank, grades, extracurricular activities, etc.) could be readily developed because they
are likely to have been summarized on applicants’ files before they are ruled upon by
admissions committees.\(^{46}\)

III. RETHINKING GOLDBERG

These cases and others create continuing debate not only about the appropriate role
for the endowment effect in due process analysis, but also about the analysis itself. To
some extent, the issues are captured in the differences between Goldberg and Mathews
v. Eldridge. Mathews was an attempt by the Court to ameliorate Goldberg’s strict pro-
cedural requirements through a balancing process that took into account procedural val-
ues and institutional burdens before establishing due process protections. Charles Koch
addressed Mathews in an article that added a “community interest” to the government’s
interest in assessing procedures granted to the welfare (or disability) beneficiary under
Mathews.\(^{47}\) I think Charles was on to something here. By substituting a general commu-
nity interest in the provision of benefits (which includes dignitary interests in fair pro-
cedures), he, in effect, converted special communities (such as veterans communities) into

\(^{43}\) See id. at 831 & n.8.

\(^{44}\) 424 U.S. 319 (1976). The Perdue court cited the need to follow the “more strenuous notice
requirement of Goldberg” rather than Mullane v. Central Hanover Bank & Trust Co., 339 U.S.

\(^{45}\) Perdue, 964 N.E.2d at 836 n.15.

\(^{46}\) This outcome would fit well with Professors Shapiro and Levy’s notion of a standards-
based due process, which requires the government to explain itself. See Sidney A. Shapiro &
Richard E. Levy, Government Benefits and the Rule of Law: Toward a Standards-Based Theory

\(^{47}\) See Charles H. Koch, Jr., A Community of Interest in the Due Process Calculus, 37 HOUSS.
communities as a whole. Ensuring due process procedures to the community of potential beneficiaries becomes a way to recognize the endowment effect’s “effect” on due process. The “community” after all is not only subject to the endowment effect—it created it. The community effect allows process to be modified without being eliminated. It permits a higher form of process to be saved for the most important decisions, which include those supported by the endowment effect. The virtue of this outcome is that behavioral economics and psychology are used in a positive way—to understand and improve the administrative process—and not as a means to undermine it.

CONCLUDING THOUGHTS

Charles always championed interdisciplinary research and often taught law and economics at the law school (along with administrative law). I know he would applaud the integration of behavioral economics into administrative law. What I have done by incorporating the endowment effect into due process analysis is only a start.

There are so many insights yet to be gleaned. At the Administrative Conference, we are exploring how to build on the work Cass Sunstein started while in government service. The hope is that laws and regulations can be more effective if they account for behavioral characteristics. The mantra, according to Richard Thaler, is: keep it simple and make evidence-based decisions. As Thaler reports, the United Kingdom has even created a behavioral insights team, designated the “nudge” unit, which seeks to improve the effectiveness of regulatory programs by testing their efficiency.

I would like to think that our government could make room for a similar unit. If it does, perhaps we could use it to improve procedural recommendations at ACUS. So we are starting down a new road. I’m sorry Charles cannot be along for the ride.

48 See supra notes 35–38 and accompanying text.
49 See KAHNEMAN, supra note 19, at 138–40 (discussing the measuring of public perceptions and how judgments are made emotionally (the “affect heuristic”)).
50 See generally CASS R. SUNSTEIN, SIMPLER: THE FUTURE OF GOVERNMENT (2013) (arguing that a more streamlined government can improve health, lengthen lives, and save money).