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## CREDIBLE THREATS

Saul Levmore & Ariel Porat\*

*“Your money or your life” is a classic threat, and it is one that law is prepared to penalize. The sanction may occasionally do more harm than good, but for the most part the law’s treatment of such serious threats is sensible. In contrast, “If you do not lower the price of that automobile I hope to buy, I will never return to this dealership” is a threat that law ignores. The buyer is free to return the next day and reveal that the threat was a bluff. In both cases the threat is a more valuable signal if the listener can weed out bluffs. This Article suggests that there is a good case to be made for legal intervention on behalf of some commercial threats, in order to enhance their credibility and signaling value. Third-party effects do, however, complicate the analysis. We suggest that the best remedy in support of valuable threats is to put the nonthreatening party at risk in the event that it enters into an arrangement that the threat-maker previously forswore.*

*The analysis develops the ingredients for credibility in commercial, criminal, and international contexts, including the cost of executing a threat, the role of repeat play, and the calculus of what we call secondary credibility – the likelihood that a threat will be carried out even though the target complies and the danger that capitulation will bring about another threat. It then turns to situations in which a threat-maker can enhance credibility by proceeding in stages. A threat is often more credible if its execution has begun, so that the marginal cost of completion is modest, and lower than the direct benefit expected from the target’s compliance. The discussion shows that law itself, where designed to discourage threats and their execution, can perversely contribute to threat-making by constituting just such a sunk cost, or first stage of a multi-stage process.*

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## INTRODUCTION

“Your money or your life” is a classic threat issued by an assailant and it is one that law is prepared to penalize, much as it punishes and discourages its grimmer relative, attempted murder. On rare occasion the looming presence of this sanction may do harm because one who has already qualified for a criminal penalty by issuing a threat will have less to lose from taking the second step, and executing it. For the most part, however, the law’s treatment of such serious threats is explicable and sensible even though some of these threats are bluffs. In contrast, “If you do not lower the price of that automobile I hope to buy, I will never return to this dealership” is a threat that law ignores. The buyer who issues the threat has committed no wrong. If the buyer’s departure fails to trigger a price reduction, the buyer is free to return the next day and reveal that the threat was a bluff, much as the armed robber can obviously decline to take the life of one who refuses to comply when confronted with the “Your money or your life” warning. Threats often impart valuable information; in the commercial context some threat-making buyers are not bluffing, and some sellers would like to recognize them. In turn, these buyers may wish to be identified and they might do so if their threats were perceived to be credible. Although law does not normally require honesty with respect to reservation prices, especially where the strategic party is a mere consumer, there are buyers (and sellers) who would like their counterparts to know that they are serious; they hope to get a better price today by being bound not to return tomorrow. This Article suggests that some threats are better than others, and that there is a good case to be made for legal intervention on their behalf. Threats, like other assurances, are signals, and in some cases the value of a signal is high enough to justify legal support rather than discouragement or indifference.

Threats permeate every area of law, ranging from criminal enterprises to commercial bargaining and to international relations. In all these settings threats can provide useful information, but only in some cases is the signal value of a threat sufficiently great to make plausible the idea that law ought to be enabling rather than discouraging. This Article suggests that in international disputes the parties are adept at signaling and, in any event, law is unlikely to do much good by legitimating threats, in part because there is no remedy to help distinguish sincere threat-makers from strategic bluffers. In commercial settings, however, we suggest that by offering a remedy for “breach of threat” – albeit a startling one – law can improve the quality of signals that some parties wish to receive from one another.

When making a threat, A makes a demand of B, and promises, or threatens, to impose a cost on B if the latter does not oblige, or comply. We call this assurance, or negative promise, a “threat” in order to reserve the “promise” label for improvements in B’s position.

Law allows some threats and penalizes others. It might do so because of a kind of collective action problem among targets. One weapon can be waved countless times at many marks in order to secure compliance from all. If the threat imposes costs, then the dispersed targets might organize their opposition to the threat-maker through law.<sup>1</sup>

Law also makes its own threats. It imposes various notification requirements that amount to threats, as when police announce themselves before knocking in a door. On a grander scale, criminal law can be understood as a set of threats issued by the state, while tort law comprises private threats enabled by the state. But law rarely enables private threats outside of such lawsuits. If A threatens never again to interact with B if B drives too fast or fails to return a borrowed item, law does nothing to make A's threat credible, even though there is a social interest in safe driving and secure ownership rights. In the case of promises, law facilitates most mutual bargains by promising enforcement with remedies, including expectancy damages and specific performance. It refuses to do so in the relatively small set of cases where the promises have serious and negative third-party effects, such as bargains among thieves.<sup>2</sup> It goes so far as to penalize certain mutual promises, like those offering payments to public officials in return for favorable rulings. The disinclination to enable threats can thus be connected to their unilateral character or to the likelihood that they advance socially undesirable actions.<sup>3</sup>

Threats can convey information that triggers precautions and that informs the target of the intensity of another's preferences. "Here are the keys to my car; take them and return them to me tomorrow or I will probably drive home while intoxicated," provides information of great use to fellow partygoers, family, potential passengers, and innocent strangers. It threatens a crime that may or may not directly affect the target, and it suggests a socially useful precaution. If such threats are encouraged, the long-run effect is more likely to be a reduction in dangerous incidents than yet more drunk driving or even drinking. The threat is credible because the threat-maker incurs a cost, in the form of handing over the keys to her car. "Discontinue the human rights violations within your borders or we will drop bombs on you" and even "Return certain hostages to us or we will

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<sup>1</sup> In contrast, a promisor in a mutual bargain must normally part with that which he has promised, so that the same "weapon" cannot be used multiple times to extract gains. See Giuseppe Dari-Mattiacci & Gerrit De Geest, *Carrots, Sticks, and Multiplication Effects*, 26 J. L. ECON. & ORG. 365 (2010). It is interesting that it is precisely in circumstances in which the promisor can also be promiscuous, as in loose promises to make charitable gifts or expressions of love and marriage, that law has experimented with formalities and suits for dashed expectations.

<sup>2</sup> RESTATEMENT, *supra* note **Error! Bookmark not defined.**, at §178; FARNSWORTH, *supra* note **Error! Bookmark not defined.**, at §5.

<sup>3</sup> See Shavell, *supra* note **Error! Bookmark not defined.**, at 1894-95 (discussing different aspects of threats and how they can negatively impact social welfare). Inasmuch as we have defined a promise as the harbinger of a benefit, it is hard to identify many unilateral promises that promisees would want to discourage. Again, there are unilateral promises that third parties, or the law, might wish to discourage, including promises that beget illicit behavior but, for the most part, information about prospective benefits is desirable especially when there are mechanisms for increasing credibility. Moreover, in commercial settings, there will normally be some protection against strategic misrepresentation and outright fraud.

invade your country” may or may not involve wrongful interventions under international law,<sup>4</sup> but again these threats seem constructive in support of legal rights. They send signals, but the target needs more information in order to assess the credibility of either threat and, therefore, the desirability of compliance.

In international affairs, threats are a common tool, perhaps because they are no less enforceable than assurances of benefits<sup>5</sup> and because they can be structured in a way that makes them relatively inexpensive to carry out and, therefore, credible. Credibility is important for both promises and threats, and it is the focal point of this Article. Credibility can enhance communication. It is, as we will see, something of a puzzle that law declines to enable credible threats where the threatened action is not wrongful. This minor asymmetry between promises and threats leads to the suggestion that in certain commercial settings it might be sensible for law to facilitate credible threats.

## I. NEGATIVE PROMISES IN COMMERCIAL CONTEXTS

### A. *Remedy for Breach of Threat*

The importance of credibility to the value of threats as signals is clearest where there is no doubt as to the propriety of the threatened action. Consider a merchant-seller, S, who offers an automobile at a price of 100. A buyer, B, evaluates the offer and then says “If you lower the price to 75, I will buy it now; if you do not, I will leave and never return to your place of business.” The negative promise, or threat, might offer S a benefit to the extent that it conveys information about B’s reservation price. An experienced merchant is likely to be better at reading customers’ intentions than is a typical consumer able to discern the merchant’s reservation price or enthusiasm to be rid of inventory. Each has information the other would like, and especially so if the good is unique and has no market price.<sup>6</sup> In this context, under current law, S is better able to convey sincerity than is B. If S promises “This is my lowest price, and if I lower the price within the next thirty days I will refund the difference to you,” a court will enforce the promise. Such an enforceable promise does not reveal S’s reservation price, but it offers B some protection against the most likely misstep that follows a misassessment of that price.<sup>7</sup>

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<sup>4</sup> Louis Henkin, *Kosovo and the Law of “Humanitarian Intervention”*, 93 AM. J. INT’L L. 824 (1999) (discussing the “troubled law of ‘human intervention’” after NATO intervened in Kosovo).

<sup>5</sup> See Eric A. Posner & Alan O. Sykes, *Optimal War and Jus Ad Bellum*, 93 GEO. L.J. 993 (2005) (suggesting that the U.S. has used military force against other countries relatively frequently even though international law seems to permit the use of force in very limited circumstances).

<sup>6</sup> See e.g., Omri Ben-Shahar & Lisa Bernstein, *The Secrecy Interest in Contract Law*, YALE L.J. (2000) (discussing the parties’ interests in hiding information from each other regarding their reservation prices).

<sup>7</sup> Note that a straightforward rule (or opt-in regime) requiring parties to reveal reservation prices preceded, we might imagine, by an agreement to strike a deal at the midpoint and share the surplus, theoretically attractive but unworkable. It is attractive because parties would reach all

It is more difficult for B to show sincerity. If B insists that his reservation price is 75, he can nevertheless offer more once the 75 is rejected by S. S will hardly complain. Even if B buys elsewhere for more than 75, no court will recognize a claim by S that she would have lowered the price and benefited from a sale to B at a price above 80. As is usually the case in contract law, B can overcome the nominal legal rule by introducing some complexity and transaction costs. B might say “I want you to believe me that I will not buy this car for anything more than 75. I think you will sell it to me at that price if you are certain that I will not back down and buy it for more. I do not know a way to convince you with mere words, so here is what I have done. You can look at this contract in my hand; it shows that I have promised to buy a similar automobile from another Seller, S2, before 2 o’clock this afternoon, unless I am able to purchase the automobile you and I are discussing for 75 or less. I am obliged to buy that good at 76 (or any other price) unless I can show a receipt for 75 or less.” In this case, the third party will have an incentive to enforce B’s threat. Alternatively, B might declare: “Here, on the phone, I have intermediary, M, who is in the credibility business. I have already given M 50, and M will take that for herself if I pay you more than 75 for this automobile. I can, of course, dissemble, but M has 50 to gain and so is likely to see whether I have the car in my possession, and then seek evidence of the place and price of purchase.” Essentially, B can use a third party to make his threat credible. There are various alternatives, including the parties’ stipulating damages, but each is unwieldy and costly. One way to think about a legal system that sought to enforce threats is that it, as with so many other legal rules, would aim to save transaction costs.

Law might offer B (and S) an easier means of establishing credibility. For example, just as some legal systems have enabled serious unilateral promises by recognizing a formality,<sup>8</sup> law could provide that statements about reservation prices can be relied upon if written and signed or, alternatively, recorded in a central registry accessible to every buyer and seller through a convenient application on smartphones. The idea is empower B to “threaten” that he will not buy at a price above 75 in order to get a price reduction from S, who might, in turn, want to know when B is really serious about his intentions. Once we allow that law might need to change in order to make it easier for the parties to communicate in this manner, we can also consider a straightforward remedy for “breach of threat.” B might stipulate (enforceable) damages (“If I return to deal

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efficient bargains and would no longer need to invest in learning about one another’s preferences and bargaining habits. A subset of this fanciful idea is that of avoiding litigation by asking a third party to compare reservation “prices,” which is to say the defendant’s best offer and the plaintiff’s minimum acceptable result, and then announce a settlement somewhere in the bargaining space if there is, indeed, such a space. One problem with these plans is that the parties have an incentive to misstate their positions.

<sup>8</sup> FARNSWORTH, *supra* note **Error! Bookmark not defined.**, at §2.5 (stating that while gratuitous promises are typically unenforceable, they are enforceable when “there is some alternative basis for enforceability, as there was in the case of a gratuitous promise under seal before the seal was deprived of its effect”).

with you, I owe you 125”). Alternatively, if counterintuitively, the rule might be that if B registers the threat but then returns to S and offers to buy at 80 then, if B and S make the deal at 80, B may subsequently recover 5 *from* S. In other words, B’s threat, backed up by the new remedy for breach of threat, forces S to sell at the threat point or not at all.<sup>9</sup> The remedy is placed in B’s hands, even though it is B who broke his own commitment, because if the parties know the remedy will be in S’s hands, B’s threat will not be credible inasmuch as they will also know that S is unlikely to pursue a claim after successfully selling to B.

### *B. Renegotiation*

The proposed remedy for breach of threat requires that B and S know they will be unable to renegotiate. In the case of most positive promises, as when B agrees to buy a car for 100, B and S can renegotiate the price up or down, as well as the terms of delivery, although they do so in the shadow of contract law’s remedies for breach of the original contract. They might renegotiate because repeat play suggests that to do so will be good for their relationship, or they might because of changed market conditions and a desire to avoid legal remedies and transaction costs. In any event, they have the option to renegotiate, though one party can always stand on its legal rights. But if there is no agreement and B aims for a price of 75 by averring that he will owe 30 or more to S if he leaves empty-handed but then returns and agrees to buy the item for more than 75, there is the “danger” that S might renegotiate and forgive the original threat. B will return and say: “Okay, I now agree to pay 80, but it is obviously not worth 80 plus the 30 to me. As such, I will return to your dealership only if you agree to set aside my threat of yesterday.” At this point, S has no desire to enforce B’s threat. And without S’s making a claim against B, the earlier averment by B accomplishes nothing; it is at best a very weak signal. S will know that B knows that S, *ex post*, will probably be disinclined to discourage typical buyers by suing B after a perfectly good sale at a price representing a triumph for S. As such, any remedy for breach of threat, aiming to increase credibility and the strength of B’s signal, must be strong enough to survive attempts at renegotiation. An elegant solution is for law to enable B to convey sincerity by holding, as before, that following the certified threat, if the parties renegotiate and agree on 80, B can sue S for 5. The idea is that S has no incentive to renegotiate for a price above B’s threat point of 75.<sup>10</sup>

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<sup>9</sup> Law could simply fine or otherwise penalize one who breached a “serious” threat, but it would need to identify carefully those “good” threats it wanted threat-makers to carry out. Moreover, enforcement would be difficult because the target would have no reason to report the breach. It is even more fanciful to imagine law’s subsidizing the completion of the threat process in order to enhance the credibility of (desirable) threats. If B were paid to uphold his threat, B would start to make threats that were both privately and socially undesirable. Note also that the threat, or bluff, never to return to the dealership is designed to avoid escape strategies; B does not want S to think he can always encourage further renegotiation by switching to a slightly different vehicle or adding a small accessory to the vehicle.

<sup>10</sup> Once such a full remedy for breach of threat is accepted, it becomes clear that the parties might prefer a partial remedy, in the same way that mutual promises are sometimes enforced with a



In sum, renegotiation appears to get in the way of credible threats. Ex ante there are cases where B (and therefore S) wants to make a threat credible in order to send a valuable negotiation signal; ex post, however, S will often have no interest in seeing the plan through. In a case where the seller and not the buyer is a repeat player, as when B is a consumer looking to purchase an automobile from a dealer, S, the counterintuitive remedy suggested above may be the only workable one.

### *C. The Seller's Perspective*

#### 1. Distinguishing Strategic Threats

For S to benefit and accept such “offers” from B, S must have reason to think that any buyer, B2, willing to pay more than 75, will not simply mimic B, anticipating that S will capitulate and lower the price. Absent special knowledge of the pool of potential buyers, S can indeed distinguish B from B2. In general B2, willing to buy at 120 but of course eager to buy at 75 if possible, will not make the same enforceable threat as B. B, who is sincere, loses nothing if S declines, because by hypothesis B was unwilling to buy at a price greater than 75. B2, however, loses the benefit of a purchase at a price between 75 and 120. In turn, S will know that one who makes the enforceable threat is more likely to be a sincere buyer than is one who simply tries to get a better price by claiming, in an unenforceable way under current law, to be making a final offer. In short, B2 will not simply mimic B because the imitation comes at a cost to B2. In turn, or when this is likely the case, S can be expected to welcome offers that come with the threat set out here. S pays a price for the knowledge that B’s threat is sincere, but it can be a price worth paying.

Of course S can benefit by turning down buyers’ offers if enough strategic buyers, like B2, return and deal at a higher price. But it will not pay for S to turn down all the offers. Imagine, for example, that S sensibly follows the strategy of responding to (enforceable) threats by accepting 50% of such offers. S might trust his ability to read buyers and follow a different mixed strategy, but for expositional purposes imagine that S simply flips a coin and accepts half the offers accompanied by enforceable threats of the kind advanced here. All buyers can reason that S will not adopt the strategy of capitulating to all threats; similarly all will know that S will not do well by never surrendering to threats. S can be expected to follow a mixed strategy. In turn, B has nothing to lose from making a threat, because B has no interest in a sale at a price above 75. B2, in contrast, will lose some fraction of the time – when S refuses the offer according to his mixed strategy, but would have sold at a price lower than B2’s reservation price and yet above 75.

It follows that S will know that one who makes the enforceable threat is more likely to be sincere than one simply tries to get a better price by claiming, with

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remedy that offers less than full compensation, so that breach remains attractive. Contract law offers something of a menu of remedies (from no enforcement to full enforcement, or credibility) to promisors and promisees, and it could do the same where threats are concerned.

assertions that are unenforceable under current law, to be making a final offer. B2 will not simply mimic B because imitation comes at a cost to B2. S, in turn, can be expected to welcome some offers that come with the threat set out here. S will pay a price in some of these cases, capitulating when the buyer is insincere. S pays a price for the knowledge that B's threat is likely sincere, but it can be a price worth paying.

## 2. Credible Threats by Sellers

The analysis is not much different if it is S that wants to signal with a credible threat, except that sellers often make credible commitments not to lower prices by employing agents without the authority to negotiate.<sup>11</sup> Moreover, sellers are sometimes bound, or even threatened, by the law of misrepresentation or fraud, as noted earlier with the example of the seller who promises that there will be no price reduction in the future.<sup>12</sup> Buyers have reason to think that such sellers are truthful because in the event of price reduction a buyer need only show that it was planned, perhaps by pointing to advertising arrangements made by the seller, in order to bring a claim. In anticipation of this, or simply to advance credibility, S will often promise "If I do lower prices within the next two weeks, I promise that I will give you a partial refund, so that you will lose nothing by buying today at 90." The promise is enforceable inasmuch as B's patronage is regarded as an acceptance that rounds out a mutual bargain. Note that this approach is superior to one that is symmetrical to the strange remedy for breach suggested above. If S promises not to lower prices, and then B were to owe S money when S does lower prices (so as to discourage the reduction and in turn solidify the threat), S might still lower prices in order to gain business from other customers.<sup>13</sup>

The preceding example presented a professional seller and one-time buyer but, of course, the example can be inverted when it is the seller who is expected to engage in one transaction, and the buyer who is likely to take other transactions into account. The strategy for using law to increase credibility is the same.

Somewhat similarly, consider the seller who advertises a one-time offer. B accepts and is then surprised when the offer is repeated later on. The case is like that presented by the buyer who promises never to return to the dealership because his threat amounted to one-time offer, but the two are dissimilar in that the surprised seller is happy to see the buyer return at a higher price, while the surprised buyer might be disappointed to learn that the seller's negative, one-time, offer was false. The buyer has lost the option value; he might have preferred to defer the purchase in order to see whether he still wanted the item at the later

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<sup>11</sup> Cf. Douglas G. Baird, *Commercial Norms and the Fine Art of the Small Con*, 98 MICH. L. REV. 2716, 2724 (2000) ("Unsophisticated consumers are often better off in a market in which no one can bargain for special terms than in a market where everyone can.").

<sup>12</sup> FARNSWORTH, *supra* note **Error! Bookmark not defined.**, at §4.9-15 (describing misrepresentation and reliance in contract law).

<sup>13</sup> A promise not to lower prices might be prohibited by anti-trust law. See Note, *Leegin's Unexplored "Change in Circumstance": The Internet and Resale Price Maintenance*, 121 HARV. L. REV. 1600 (2008) (explaining courts' treatment of resale price maintenance).

time. Yet it is unlikely that this buyer will succeed in court because damages are hard to prove. And if the buyer had not accepted the one-time offer, it is even more difficult for him to claim a loss when the seller's offer proves to be anything but one-time. It would seem sensible for law to offer the seller a means of making a credible one-time-offer assertion.

#### *D. Efficiency and Breach of Threat*

The suggestion that S and B would benefit from a remedy for breach of threat is not the same as claiming that the remedy would promote efficiency. Virtually all such claims about empowering ex ante decisions, even when there is ex post pressure or agreement to undo the past, run into questions of whether we can be sure that advance planners are really able to evaluate future circumstances. Binding oaths, stipulated damages, and various waivers are all means of empowering ex ante agreements, and such agreements can be critical to promote desirable investments, partnerships, and effort. In extreme cases, renegotiation is made impossible. The idea of empowering B's threat can be seen as just another example of the sometime attraction of allowing parties to believe that they have sufficient foresight, and even superiority over their future selves or successors, to bind themselves. Much as constitutional provisions can be difficult or impossible to amend, and gambling addicts can put themselves on a list of persons barred from casinos under penalty of law,<sup>14</sup> it may be sensible to allow parties to make some contractual provisions permanent and immune to renegotiation.<sup>15</sup> On the other hand, law no longer allows eager borrowers to agree to debtor's prison or slavery in the event of default. On a middle ground, law permits prenuptial agreements that make divorce less likely than the future self might like;<sup>16</sup> it surely allows limited covenants not to compete;<sup>17</sup> and it enforces stipulated damages up to a point.<sup>18</sup> In all these cases, legal enforcement is less likely as the restriction seems less efficient ex post. It is not obvious how to fit the proposed remedy for breach of threat in this group. The committed threat-maker must recognize that new information will bring on regret, not to mention ex post inefficiency.<sup>19</sup> The

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<sup>14</sup> Jim Holt, *The New, Soft Paternalism*, N.Y. TIMES (Dec. 3, 2006), [http://www.nytimes.com/2006/12/03/magazine/03wwln\\_lede.html?oref=slogin&r=0](http://www.nytimes.com/2006/12/03/magazine/03wwln_lede.html?oref=slogin&r=0) (stating that “[i]n some states with casino gambling . . . compulsive gamblers have the option of putting their names on a blacklist . . . that bars them from casinos” and that “[i]f they violate the ban, they risk being arrested and having their winnings confiscated”).

<sup>15</sup> See Christine Jolls, *Contracts as Bilateral Commitments: A New perspective on Contract Modification*, 26 J. LEGAL STUD. 203 (1997).

<sup>16</sup> RESTATEMENT (SECOND) CONTRACTS at §189 (promise in restraint of marriage) (1981).

<sup>17</sup> ERIC POSNER, *CONTRACT LAW AND THEORY* 208-11 (2011) (explaining that courts enforce reasonable covenants not to compete); FARNSWORTH, *supra* note **Error! Bookmark not defined.**, at §5.3 (discussing standards that courts use to evaluate covenants not to compete).

<sup>18</sup> RESTATEMENT, *supra* note 18, at §356 (stating that stipulated damages must be “reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss”).

<sup>19</sup> See Oren Bar-Gill & Omri Ben-Shahar, *The Law of Duress and the Economics of Credible Threats*, 33 J. LEGAL STUD. 391 (2004) (arguing that when modification of a contract is imposed

parties do have high transaction-cost alternatives, and perhaps that makes it unlikely that law will provide ready off-the-rack rules for those who think they want help in making credible threats.

A second reason to resist an efficiency claim is the possibility that law has not created a menu of threat options because of third-party effects. It may be that a given buyer, B, would like a seller, S, to know that when he, the buyer, threatens to abandon the transaction unless S lowers her price, the threat is a real one, backed up by legal remedies that make bluffing implausible. However, while B and S can choose to make B's threat more credible, other buyers will find that their conventional threats are taken even less seriously than before because sellers will reason that the threat-makers did not avail themselves of this new category of the enforceable threat. The proposed remedy for breach of threat sorts a group of previously undifferentiated parties into two groups. It is not obvious whether the new equilibrium that will emerge is socially more desirable, especially where it is created by law rather than by an enterprising seller.<sup>20</sup> On the one hand, it is arguable that the benefits of clearer signals would accrue to all, or at least to many. For example, in legal systems where a donor can make a charitable pledge more credible by putting it in writing, there is no cry from other putative donors and from recipient organizations that well-meaning verbal pledges are useless, and would become more meaningful signals (on average) if the device for allowing credible pledges were to be undone. On the other hand, it must be the case that if law sorts signals, and makes one category more credible, then those not included in the category are less credible. The dynamic process associated with sorting into the two groups makes it difficult to generalize about efficiency.<sup>21</sup> One easy intuition is that the proposed remedy is more likely to promote efficiency if the remedy for breach of threat allows increased credibility without

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by one party on the other, a duress claim should not apply if the unmodified contract would have been inefficiently breached).

<sup>20</sup> The suggestion that the seller might have initiated the sorting mechanism advanced here raises the familiar question of why the proposed legal innovation has not been developed by the parties themselves. One possibility is that parties recognize law's antipathy toward tools, like penalty damages, that might be ex post inefficient and much regretted. Another is that the counterintuitive remedy is too odd for normal evolution with respect to commercial practices. For a similarly counterintuitive remedy, that has also not yet made it into law, see Omri Yadlin, *The Conspirator Dilemma: Introducing the "Trojan Horse" Enforcement Strategy*, 2 REVIEW L. ECON. 25 (2006) (suggesting that undocumented workers be allowed to sue their employers for large fines in order to deter the employers from hiring the workers).

<sup>21</sup> Imagine, for example, a set of taxpayers who do not like the uncertainty of future audits. They would prefer a system in which one could insist on an audit upon filing a tax return and then either owe money or receive a guarantee that the tax return was accepted and no further money would be owed the government. With such an option in place, the government might then know to devote additional resources to auditing those who chose not to avail themselves of the new quick-and-certain audit option. In turn, some taxpayers who would not have chosen the new option will find it worthwhile to choose it. In the end, it is unclear whether the sorting produces a social gain. For an argument in favor of such a scheme, sorting taxpayers by their willingness to cooperate with enforcement, see Alex Raskolnikov, *Revealing Choices: Using taxpayer Choice to Target Tax Enforcement*, 109 COLUM. L. REV 689 (2009).

high attendant transaction costs.<sup>22</sup>

## II. CREDIBILITY WITHOUT LAW

In the commercial context explored in Part I, a threat was a signal, but one which might be made more powerful if both parties knew that a breach might have consequences. But even if there is no remedy for breach, a seller might benefit from hearing a buyer threaten never to return. The seller is free to evaluate the signal as she pleases. It is unlikely that a pool of silent buyers, not to mention discouraged buyers, is to be preferred by the seller over a pool in which some subset provide (unenforceable) negative promises. In contrast, if a criminal displays a weapon and offers V “your money or your life,” law would like to discourage the “transaction,” and certainly to discourage the criminal from proving reliable in the first-order sense of the negative promise to kill V unless V hands over the money in his possession. If the criminal turns out to be bluffing, we recognize that offering someone a remedy for the criminal’s failure to keep his promise runs the risk of encouraging the completed crime of murder. It is not obvious that the criminal who merely bluffs ought to be punished for the attempt or the threat, for to do so may encourage the criminal to carry out the crime both because V is now a witness to the threat or attempt and, more interesting, because the marginal cost to the criminal of carrying through on his threat might now be lower.

An evaluation of law’s role in enhancing credibility, for better or worse, is informed by some analysis of the ingredients for credibility. The most obvious ingredients are the costs to the threat-maker of carrying out his threat as well as the benefits to him from establishing a reputation for credibility.

### A. *Execution Costs*

Threats are more credible when the cost of execution is low. They are, therefore, often more credible than promises in the absence of law because benefits usually cost the promisor an amount approaching (and in some cases exceeding) the benefit to the promisee. For example, when an employer promises and then gives a promotion and raise, the employer must actually spend the money that the promisee receives. In contrast, the extortionist-arsonist needs but a can of gasoline and a few matches in order to make good on his threat. Indeed, a simple explanation of much of the criminal law regarding threats is that the prospect of punishment under law raises the cost to the threat-maker who would otherwise find extortion too easy and profitable. Much as laws against theft save precaution costs and allow parties to devote resources to productive rather than

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<sup>22</sup> On signal sorting, see ERIC POSNER, LAW AND SOCIAL NORMS 18-27 (2000) (sorting good types and bad types of actors).

merely redistributive activities, so too laws against threats – especially where the signal value is low – can save resources by raising the costs of the unproductive threat-maker.<sup>23</sup>

Assume that T makes a threat and has the power to execute it, and that T's target, V, knows this to be the case. Assume further that V will find it cheaper to capitulate than to suffer the penalty that T threatens to execute. Of course, V may comply and then find that T executes anyway. We call this a secondary credibility problem, and note for now that when V contemplates capitulation, V must estimate not only the likelihood that T will carry through on T's threat, but also that T will not execute if V capitulates, or complies. A third assumption is one that we will often relax: T receives no direct benefit from execution, but makes the threat in order to receive something of benefit from V. When this assumption is relaxed, T benefits from execution in addition to any benefit from V's compliance. A minor distraction is V's ability to reduce T's benefit. V might respond to "Your money or your life" by taking out her wallet and quickly destroying its contents (or assuring T that she will do so). We set this "scorched earth" strategy aside and return to it where it might make V not just indifferent but better off by reducing the credibility of T's threat.<sup>24</sup>

These assumptions, or components of a threat, can illustrate some fundamental mechanics and puzzles. When T says "Your money or your life," T implies that if V does not capitulate, T will take the money anyway after executing the larger threat; in any event, V will be in no position to enjoy money. With the money in hand, T will have benefited from executing the threat. V has reason to think that compliance reduces the likelihood of execution. If V refuses T's demand, T faces the cost of execution (apprehension and its consequences for the most part) but gains the money in V's pocket as well as the benefit of eliminating a witness. But if V complies, T's benefit from execution is much lower because the money has already been transferred. To put the third assumption in play, with no direct benefit to T from execution, the threat should be something like "Give me your money or I will torch your business on Main Street." The execution of that threat produces no direct gain to T. In such a case the cost of execution is the same whether V complies or not. Without repeat play, execution seems incredible because there is, let us assume, some cost to T, and yet no benefit. In contrast, even without repeat play, "Your money or your life" is more credible.<sup>25</sup>

It is apparent that the credibility of a threat depends in large part on the cost and benefit of execution, including the costs imposed by law. "Your money or

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<sup>23</sup> See Coase, *supra* note **Error! Bookmark not defined.**, at 671 (arguing that blackmail does nothing more than transfer wealth and because there is no reason to think that it is a transfer to a higher valuing user, it should be prohibited by law).

<sup>24</sup> See *infra* Section III.A. Note that from a social and ex ante perspective, the scorched earth strategy may be ideal.

<sup>25</sup> "Your money or I will end a stranger, W's, life" is as incredible as "Your money or I will torch your business," and less likely to motivate V. It is yet more incredible if V expects T to be angry with V (but hardly with W) once V refuses to comply.

your life” is not completely, or doubly, credible unless V thinks that by turning over her money, her life will be spared. But this requires some assumption about T’s fear of apprehension, for that is the major cost component of execution. Credibility requires only that it be greater than zero, or that T has some moral qualms about the taking of life.

### *B. Repeat Play*

The commercial example in Part I focused on an occasional buyer with no reputational interest, but it is apparent that if a threat-maker, T, is a repeat player, then credibility is enhanced because a target, or victim, V, will know that T profits from building a reputation for credibility. But the matter is complicated both by the likelihood that V is also, or is in danger of becoming, a repeat player, trying to build a reputation that will discourage future threats, and the possibility that repeat play has an asymmetric impact on reputation. In particular, past reliability does not provide much information about the future, except that it is better than past unreliability.

A threat-maker involved in repeat play is not necessarily more credible than one known to be a one-time signal sender. In some circumstances, the rational, and certainly the impulsive, target will comply only if there is a guarantee that the threat will not be repeated, whether by the first threat-maker or another, and this can be as difficult to make credible as the original threat itself. The danger is compounded where compliance itself signals something unknown to threat-makers, namely the costs, benefits, and vulnerability of the target to the particular threat. This feature is at the heart of much diplomacy, corporate “greenmail,” and other threat-laden interactions.

Consider a target corporation facing a hostile acquirer and contemplating making a payment in return for an end to the hostility. In order to avoid a suit for fiduciary breach, the payment might be styled as reimbursement for the costs of identifying hidden value in the target. The target must fear that its willingness to pay will bring on other acquirers who hope to extract similar payments. Compliance is costly but the direct benefit to the threat-maker makes the threat credible. The most sanguine explanation for these greenmail payments is that the acquirer has identified something of value in the target, and is then paid for this information. A much less optimistic interpretation is that the target’s managers seek to preserve their positions by making a payment that is to their shareholders’ detriment.<sup>26</sup> Following the sanguine narrative, there is no danger of further threats (and indeed there was never really a threat but rather the offer of information) because the information is now in the target’s possession. The pessimistic view of the transaction is puzzling because it would seem that other threat-makers will simply come forward, now that it is known that the target’s managers are

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<sup>26</sup> Jonathan R. Macey & Fred S. McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 *YALE L.J.* 13, 14-15 (1985) (discussing greenmail, a corporate defense tactic that has been criticized as “a self-serving attempt [by management] to prevent a shift in corporate control that would threaten their jobs”).

vulnerable and will pay, with corporate funds no less, to keep their jobs.<sup>27</sup> In turn, the target should be disinclined to pay because payment invites further threats.

In the international arena, the danger of follow-on threats is at least as great, and suggests that while repeat play might make a threat more credible, it greatly raises the expected cost of compliance (viewed over multiple rounds). In turn, this leads to the observation that repeat play alone does not increase credibility and thus beget threats, unless the threat-maker is in a position to reduce the target's fear of threats from other sources. Organized crime offers an obvious domestic analogue, or illustration. Extortion-induced protection money forms an attractive stream of revenue, but this business model works only where the criminal organization enhances credibility by occasionally making good on its threats *and* effectively maintains a geographic monopoly or other means of assuring the targets that other entities will not appear and demand payments.<sup>28</sup> Similarly, a labor union's threat is often secondarily credible because no other union can call a strike, even after the target's vulnerability is revealed.<sup>29</sup> Returning to the international arena, a government that pays another country or a terrorist group to release hostages must have reason to believe that it or the rewarded threat-maker has the means of preventing other entities from grabbing another set of hostages.<sup>30</sup>

There are other reasons why repeat play does not guarantee credibility. A respondent must always be skeptical of an attractive track record, lest a sting be mistaken for reliability. The target needs to know about the future opportunities of the other party rather than about its past reliability. Inasmuch as the latter is more observable than the former, it is sensible to take one as a proxy for the other, but within limits. If, for example, S delivers widgets to B in return for promised payment, performance by both parties may raise the likelihood of future transactions between them because each has evidence that the other is reliable. But, of course, there is always the danger that performance costs have been absorbed in order to encourage a subsequent round in which the strategic player will underperform, especially if the stakes are higher in the later round. The problem looms larger the fewer the time periods. One never knows whether performance is indicative of the future or, to the contrary, intentionally misleading. Past reliability is probably a modest inducement to future

<sup>27</sup> A hybridized story is also plausible. The target may have information about its own worth that it needs to keep secret for good business reasons. The first acquirer discovers the information and is now paid to depart and be silent. Here there is a threat (of disclosure) but no danger of copycat threats.

<sup>28</sup> Thomas C. Schelling, *What is the Business of Organized Crime*, 20 J. PUB. L. 71, 73 (1971) (arguing that one characteristic of organized crime is that it allows no competition and exercises a monopoly); Shavell, *supra* note **Error! Bookmark not defined.**, at 1882 (stating that a threatening party may want to carry out a threat when its demand has been rejected for the purpose of establishing a reputation).

<sup>29</sup> Richard A. Posner, *Some Economics of Labor Law*, 51 U. CHI. L. REV. 988, 996 (1984) (discussing a labor union's exclusivity with all employees included in a bargaining agreement).

<sup>30</sup> Harvey E. Lapan & Todd Sandler, *To Bargain or Not to Bargain: That is The Question*, 78 AMERICAN ECON. R. 16 (arguing against the conventional wisdom that governments should not bargain with terrorists over hostages in order not to encourage further hostage taking).



transactions. If it is more than that, it because we think there are “good types” and not so good ones, and as there is evidence of past performance, the observer updates until it is very likely that among those who have been repeatedly reliable, only a very few are waiting to sting.

Correspondingly, a threat-maker with a history of carrying out threats when a target fails to capitulate is either identified as a bad type or is seen as credible because the target perceives that this threat-maker is perfectly capable of threatening and executing again. Moreover, the threat-maker is not investing in reputation. Past execution may also reveal that execution costs, if unknown to the target, are in fact relatively low, so that the threat is more credible. But the analyses of a threat-maker and promisor’s reputations are not identical. First, execution reveals a bad type if it concerns a wrongful act, while performance does not necessarily reveal a good type because it may be an investment in a future sting. Second, the issuance of a threat is often cheap, and its execution is often inexpensive as well, so that the margin between the threat-maker’s costs and its expected benefit from the target’s compliance can be large. In contrast, most bargains over benefits require effort or payment on both sides, and a large margin of gain is unlikely. As such, past behavior is likely less reliable for threats than for promises. Finally, but cutting in the other direction, a previous successful execution of a threat regarding a wrongful act may show that this particular threat-maker has no fear of the law, or is in collusion with those who enforce law. If so, its threat and execution costs are both low, and its threats are more credible.<sup>31</sup>

### *C. Secondary Credibility*

Secondary credibility, defined as the perception that the threat-maker will abide by its implicit promise not to execute and also not to repeat the threat if the target complies, is especially striking where it is low because of past unreliability. If one knows that a blackmailer or other threat-maker will prove unreliable in the secondary sense of returning with a second threat, then it is irrational to comply with the first threat unless delay is of benefit or one would have complied with the larger threat (comprising the first and second threats combined) in the first place. Nevertheless, in a variety of settings there seems to be a remarkable, nearly universal, and seemingly irrational equilibrium or focal point; a threat-maker is not trusted, and indeed may be regarded as beneath contempt, if a threat turns out to be the first of several. The same is true where a threat-maker decides to be secondarily incredible in order to gain information. At a flea market, the understanding is that the seller, S, starts high and proceeds towards some middle point (if at all), while the buyer, B, starts low and increases his offer until the

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<sup>31</sup> By “threat costs” we refer to the fact that if law makes the threat illegal, then there is a cost to making the threat apart from any associated with execution. The role of law in forming threat costs is explored further in Part IV, but in most cases discussed to this point threat costs can be ignored. Of course, as in the commercial setting explored in Part II, when the threat is not something law penalizes, there may be no threat costs.

parties do (or fail to) agree to a sale. But the unwritten rule is that once there is nominal agreement, no further testing is acceptable.<sup>32</sup> By way of illustration, imagine that S asks 20; B responds with an offer of 12; S reacts by lowering her price to 18; B rejoins with 15; and S accepts and begins to hand over the item. If B now hesitates: “Well, on second thought, I’ll buy it for 10,” S will often end the bargaining process and regard B as a contemptible rule-breaker. It is somehow wrongful for B to explore for S’s reservation price in this manner. The simplest explanation is that the seller recognizes that there was a meeting of the minds and that, at least in principle, law requires that the buyer go through with the transaction. Another explanation of this observation is that a seller feels bound, whether by the law of contracts or by that of misrepresentation, to sell at a price she announces, so that any asymmetry seems offensive and possible only because the buyer in this sort of setting can walk away, leaving the seller no corresponding method of seeking out third-party relief. Certainly the buyer in a flea market is in no danger of losing a valuable reputation. Yet another explanation is that if either party can change his or her mind after the other accedes to a previous offer, there is too much uncertainty around the question of when a bargain is ever reached.

Consider, finally, the blackmailer who proves secondarily unreliable and returns for a second extraction. Without expressing sympathy for the blackmailer, we can understand his position; if credibility requires that the business be completed in a single transaction, then the blackmailer is uncertain how much to demand. If he starts high and lowers his price in the event of noncompliance, his threat seems weak. And if he starts low and then raises the price in the event of quick capitulation, he seems unreliable. Perhaps the blackmailer should say at the outset: “I will reveal X about you unless you pay me 100. If you do pay me 100, I will withhold the information for one year. If you pay now, you should know that I might return in a year to demand payment for next year.” The target may take precautions during the year, but the threat-maker may also see that the price will increase next time. If this strategy works, then it reveals that targets think in terms of good and bad types. If it does not, it may be because the parties comprehend the flea market seller’s sense of honor, or convention, in the face of instability. Alternatively, a blackmailer may succeed, which is to say be more credible, when there is a natural time frame to the threat, so that the fear of repeat threats is eliminated. For example, a particular threat might dissipate once the target is elected, receives an inheritance, or is protected by a statute of limitations.

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<sup>32</sup> We are grateful to Omri Ben-Shahar for the example and discussion of its implications. The convention discussed in the text is also reflected in cases where strangers pay to avoid a harm that law is unlikely to reach. For example, SaveToby.com was a website on which the creators claimed they would eat a cute rabbit unless donors collectively paid \$50,000. Deadlines were extended and there was an unverified claim that about half that amount had been collected. There followed a Save Toby book, threatening to kill Toby, who had been saved once, unless 100,000 copies were sold. At that point, the venture was understood to be humorous rather than threatening. The book might be understood as destroying any credibility attached to the first threat. See [http://en.wikipedia.org/wiki/Save\\_Toby](http://en.wikipedia.org/wiki/Save_Toby)

## III. CREDIBILITY THROUGH MULTI-STAGING

A. *Bullying by Sinking Costs*

A threat-maker can enhance credibility by expending resources, and can do so even where it would seem that no credible threat is possible.<sup>33</sup> Imagine a Country T that threatens to invade its neighbor, V, unless the latter cedes control of disputed territory. V finds the threat incredible because it knows that the cost of invasion to T is greater than the value of the territory at stake. Imagine that costs and benefits are similarly assessed by the parties; the territory in dispute is worth 100 to each; invasion costs T 120 and would impose direct costs of 50 on V; and the invasion would be successful from T's perspective because it would control the territory in question and thus transfer 100 from V to itself. Finally, neither country gains anything when the other incurs costs. At the outset T's invasion threat is not credible because it must spend 120 to gain 100. It tries to bluff because V's costs amount to 150 (the 50 from invasion plus the loss of the territory), but V can see that from T's perspective the invasion is too expensive. Of course, T's threat might be credible if T would benefit from building a reputation for reliability, but we resist adding assumptions that make the problem easier and less interesting.

But imagine further that the 120 cost to T is the sum of 30 for mobilizing troops, another 30 for amassing equipment at the border once the troops are in place, and then 60 for the expected loss of life and equipment in an actual invasion. T might now proceed with mobilization. Following this first step, V will perceive that T need only spend 90 more in order to gain 100.<sup>34</sup> Once T carries out the first step, the threat becomes credible. If V rationally complies after T mobilizes, T will have spent 30 to gain 100.

Yet more interesting is the possibility that mere knowledge of the preceding multi-step strategy, available to T, makes T's threat *prior* to the mobilization credible. Arguably, V will reason that a rational T will spend 30 (or 60, if necessary, to make the point yet clearer to V) in order to bring V to its knees as before, so that V will find the original threat credible even before T proceeds with the first stage. The example divides T's execution costs into three steps in order to emphasize the puzzle of backward induction or unraveling.

If it is implausible that V will find the threat, or perhaps it should be called the prospect of a threat, credible simply because T can sink costs and thereby

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<sup>33</sup> For a similar analysis in one specific setting, see Lucian Arye Bebchuk, *A New Theory Concerning the Credibility and Success of Threats to Sue*, 25 J. LEGAL STUD. 1 (1996) (suggesting that negative value suits exist because the defendant knows that the plaintiff can proceed in stages, spending some resources in the first stage, and credibly threatening to spend more in the next so that the suit can be credible even without actual expenditures).

<sup>34</sup> Note that T can sink costs by completing some costs or by taking steps that increase the value of the direct benefits available for success. If T puts some assets in the disputed territory, worth 30 to T only if T controls the territory, then again its threat becomes credible because it will spend 120 to gain 130 upon a successful invasion.

make future steps credible – even though the overall investment looks incredible – it is because there is or ought to be a hidden, if realistic, assumption that V benefits when T incurs costs, at least when the parties are enemies or competitors. We have tried to eliminate that from the illustration, but perhaps the startling result requires more. The example can, therefore, be improved by adding that as soon as T begins to mobilize, V must spend 5 to shore up its defenses, and then another 5 when T heads to the border in the second step. (Perhaps T can get to the border and then invade at costs of 20 plus 20, rather than 30 and 60, if V fails to take these defensive steps, or perhaps V suffers badly from internal instability and defections if V does nothing at all in the face of a mounting threat.). With this added assumption about some interaction between the adversaries' costs, the unraveling seems quite plausible. If T takes the first step at a cost of 30, V will find it worthwhile to spend 5. If it gets that far, T needs only to spend 90 to gain 100 and the threat is, again, credible. But rather than spend 5 and later comply, V may as well save the 5 by complying earlier, as soon as it thinks that T has figured out the multi-stage threat strategy.

The situation is, in principle, symmetrical. V can influence credibility by taking steps that make compliance impossible or at least less valuable to T. If V salts or otherwise scorches the earth, the disputed territory will be of lower value to T (as well as to V) and T's threat is less credible. Working backward, T will not threaten because it perceives V's optimal strategy. Indeed, there should be no threats but only surprise invasions. In reality, and depending on technologies, V chooses a mix of precautions, including expenditures, or sacrifices, that make it a less attractive target. In turn, T can often increase the expected gains from execution in order to enhance credibility. T might, for example, encourage its own citizens to move into the disputed territory. T and V can be understood as engaging in a game, whether we think of it as an arms' race or something quite different. But we proceed with the easier picture of T in control of the components of credibility in order to focus attention on the credibility of threats rather than on the mysteries of game theory.<sup>35</sup>

It is easy to have one of two extreme reactions to this example in which T succeeds without expending resources. The first focuses on the startling result, and reasons that the assumptions must be too strong. Perhaps the inevitability of repeat play, of perceived competitive benefits from an adversary's costs, or of miscalculations changes things in crucial ways. The opposite reaction is to observe that the unraveling may explain, if not rationalize, the success of bullies quite generally. If T is more powerful than V and can invade, spending as much as 120 (in steps of 30, 30, and 60) while imposing costs of 50 (casualties) plus 100 (when control of the territory is transferred to T) on V, then it does not matter that T gains less than 120 itself. Virtually every threat can be divided into stages, so this strategy for making a threat "appear" credible is of significance. As long as

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<sup>35</sup> Note that Bebchuk, *supra* note 34, assumes that the parties cannot affect the total costs of litigation or the expected value of the suit. The parties are also assumed to be capable of settling at any stage.

T is able to divide execution costs into stages that each costs less than the benefit to T from execution, V will capitulate. V can win only if (contrary to the illustration set out here) it can raise the cost to T of the final stage, as by defeating T's invading army. If not, V will comply in an earlier stage, perhaps even saving T the need to incur any costs at all, if each stage imposes costs on V, and T's costs are of no benefit to V. Powerful bullies operate in such environments, the argument goes, and only rarely need to carry out their threats. The stronger party's threats are always credible, and something like concerted or principled reactions are required to thwart the skilled bully.

### *B. Law as Part of Multi-Staging*

#### *1. Law's Contribution to Credibility*

When actors are subject to legal rules and enforcement, law can prevent the arm's race that is bound to occur as putative bullies build up threat-making capacity and defenders invest in otherwise wasteful precautions. If a severe legal penalty attaches to an assault, for instance, then one who threatens assault will not find it worthwhile to execute and the threat itself may be incredible. T may be able to "defeat" V but not once the law is on V's side, denying T any gain even if V complies, or putting T in a situation where the penalty owed to the state exceeds anything extracted from V. In turn, if threat-makers can induce compliance because the target perceives that the threat-maker, or his agent, does not attach either a high cost to the penalty meted out by law or a substantial chance of being apprehended by it, then law may be powerless. In order to add to the likelihood of apprehension, and for other reasons discussed presently, law often attaches penalties not just to completed *malum in se* crimes, but also to attempts and threats of many such crimes.<sup>36</sup> Moreover, many serious crimes, like rape and kidnap, double as serious crimes and as threats of murder – in the event that the target fails to comply with the criminal's plan for the initial crime. The idea is not simply that law deters the threat-maker (where a serious wrong is threatened) but also that it works to reduce crimes by reducing the return to the criminal, who will find his threats less potent (and therefore the crimes threatened less useful as leverage) because they are less credible to the targets.<sup>37</sup>

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<sup>36</sup> MODEL PENAL CODE §5 (1962) (defining attempt and conspiracy crimes). Threats are penalized directly in provisions such as §2.09 (duress), but may also be categorized as attempts by prosecutors.

<sup>37</sup> We must be careful not to lose sight of the signal value of a threat, even where the threat is about a horrible act. One might want to receive a threat of arson even if it is impossible to prevent the arson. Personal property can be relocated, and more important, the threat-maker's demand might supply information that makes it clear whether to accommodate the threat-maker or how to avoid future tangles. On the other hand, if signaling could be completely quashed, then the target and most of society would be even better off. For one thing, the question is not whether the target wants the signal, but whether all potential targets will be better off if such signals are allowed or better deterred. In the limiting case, if a kidnapper knew it would be impossible to communicate with the victim's family, then kidnapping itself might be pointless. But implicit threats always seem plausible, and so the question is whether the signal value of (wrongful) threats (not just to

The confounding factor is that when penalties attach to behavior leading up to crimes, law may perversely increase the value of some threats because they become the first step in a (now familiar) multi-stage process. Imagine, for example, that T threatens to harm V unless the latter transfers property to T. Suppose that the cost to T, in the form of legal penalty, is 10 for completing the crime he threatens to execute, and 4 for simply threatening the crime. Assuming comparable chances of apprehension, the marginal penalty for execution is 6 and depending on T's expectations about the value of V's property there can easily be situations where law will have made the crime more likely.<sup>38</sup> A partial antidote would be a rule that the separate penalty for the threat, 4, is reduced when there is also punishment for execution. Alternatively, law could in some cases charge the threat-makers with both the threat and the crime, for a total penalty of 14 and a marginal penalty of 10, but this would be unusual. With respect to the most serious crimes there is hardly room to add on to the penalty (attaching to the crime alone) in a meaningful way. In these cases, penalizing the threat probably makes the threat more credible, and indeed there will be some cases where the threat is only credible because law has made it wrongful. T would be deterred from committing the crime, but now that the marginal penalty for its commission is lower, the crime – and in turn threatening the crime – is worthwhile. Of course, it may well be true that there are many more cases where making the threat an independent wrong raises the probability of apprehending the wrongdoer.<sup>39</sup> The point is that the ability of the threat-maker to work in stages can dramatically increase the credibility of threats, and that law itself can be a source of the sunk costs that make staged threats more credible and dangerous.

## *2. Revisiting Criminal Law's Focus on Threats*

The danger that the law of threats can increase crime suggests some rethinking of first principles. First, perhaps the law should deter compliance rather than focus only on threat-making and its execution. The approach might be especially promising where the threat-maker is perceived as undeterrable. It is, however, not just counterintuitive but sometimes offensive and politically impossible to penalize a victim. The strategy must be to emphasize that when a

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the immediate target) is high enough to allow, and certainly not discourage, some threats. Moreover, there are other situations where an inability to communicate would make the parties worse off simply because it would negate the possibility of compromise. If a country threatens to invade another unless a hostage is turned over, for example, it is likely that an inability to communicate and threaten would often lead to casualties that could be avoided by the threat-and-compliance prospect. But the law of threats regarding serious domestic crimes need not be the same as that aspired to for international disputes.

<sup>38</sup> See URI ZUR, *ISSUES IN LAW AND GAME THEORY* (doctoral dissertation in Hebrew) (demonstrating that law's punishing the attempted robbery can help the robber by making his threat more credible).

<sup>39</sup> The point can be generalized with the claim that the remedy for breach or wrongdoing affects credibility. Thus, if a party to a contract hints at a coming breach, or breaches in a minor way, in order to secure some benefit from the other party, the law might or might not provide a remedy. If it does provide a remedy, then it deters the minor breach and threat, but it leaves less of a remedy to secure the larger project.

target complies, threat-makers are encouraged to threaten *other* targets. There are examples of legal systems working to discourage kidnapping by making it a crime to pay kidnappers.<sup>40</sup> Similarly, there are countries that announce that they will not negotiate with terrorists.<sup>41</sup> Where kidnapping is common, governments have sought to freeze or temporarily confiscate the assets of victimized families and firms, but this strategy discourages some victims from reporting kidnappings.<sup>42</sup> More generally, criminalizing both sides of a transaction runs into the risk of driving the transaction underground, rather than deterring it. There are other settings where threats might be discouraged by penalizing compliant targets, though the strategy can be foiled by a defense of duress on the part of the threatened party. When the threat does not rise to the level of duress, it is common for law to deter both sides, and then to rely on third-party enforcement. For example, if a public official threatens regulation or another burden, the threatened party can complain if the threat was understood as a request for an illegal payment. If, instead, the threatened party bribes the official, both parties will be culpable and the one who pays will be unlikely to succeed by claiming duress.<sup>43</sup> In turn, because both parties run the risk of prosecution, both have reason to be secretive and law enforcement becomes more costly.

The discussion here concerns criminal law, where the threat is about unambiguously wrongful behavior. But the strategy, it must be noted, is the very same “startling” one suggested in Part I on behalf of commercial bargainers who sought to make their nonwrongful threats, or signals, more credible. The buyer who wished to signal that he really would not return and offer a higher price was, arguably, best supported by a rule that allowed the buyer to sue the seller if the *seller* accepted more from the buyer upon his return. In that setting the remedy was put in the hands of the threat-maker because his target would not be expected to enforce any remedy offered to her. In contrast, here the remedy is put in the hands of the government but it, too, is aimed at the target and the idea in both

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<sup>40</sup> RICHARD P. WRIGHT, *KIDNAP FOR RANSOM: RESOLVING THE UNTHINKABLE* 23 (2009) (describing efforts made by Italy and Colombia to prevent kidnapping victims’ families from paying the demanded ransoms); *The price of paying ransoms*, THE ECONOMIST (Aug. 31, 2000), <http://www.economist.com/node/353978> (stating that it may be necessary to punish both kidnappers and those who pay their ransom demands).

<sup>41</sup> Steven L. Myers, *Hostage Crisis Unfolds in Russia as Guerrillas Seize School*, N.Y. TIMES (Sept. 30, 2004), [http://www.nytimes.com/2004/09/01/international/europe/01CND-RUSS.html?\\_r=0](http://www.nytimes.com/2004/09/01/international/europe/01CND-RUSS.html?_r=0) (stating that Vladimir Putin told journalists that “Russia would never negotiate with terrorists or separatists in Chechnya”); Hassan M. Fattah, *U.S. Rejects Truce Offer From bin Laden*, N.Y. TIMES (Jan. 20, 2006), <http://www.nytimes.com/2006/01/20/international/middleeast/20tape.html?pagewanted=all> (reporting that then-Vice President Dick Cheney said “[w]e don’t negotiate with terrorists” when asked about an Osama bin Laden audiotape).

<sup>42</sup> Celestine Bohlen, *Italian Ban on Paying Kidnappers Stirs Anger*, N.Y. TIMES, Feb. 1, 1998, available at <http://www.nytimes.com/1998/02/01/world/italian-ban-on-paying-kidnappers-stirs-anger.html?src=pm> (stating that the number of reported kidnappings decreased dramatically after ransom payments to kidnappers were banned).

<sup>43</sup> Of course, the prosecutor might reduce the charges in return for the private citizen’s assistance or simply because the crime looks less culpable. See *U.S. v. Abbey*, 560 F.3d 513 (6th Cir. 2009) (perjury and fraud charges reduced in exchange for testimony against public official).

settings is to deter the target from enabling the other party. In the commercial setting we seek to make the threat more credible, so the threat-maker collects from the target in the event of the former's breach, while in the criminal setting the idea is to make threats less credible, so the target is treated as a wrongdoer if the target complies.

The second core feature of criminal law worth re-examining is the tendency to punish threats in the first place. Why punish threats if to do so might generate more crimes, as described in the preceding section, when it is always possible to get the same deterrence by increasing the penalty at the final step? If criminal law punishes threats for the same reasons it punishes attempts, then there is nothing new to add here.<sup>44</sup> The problem is one of weighing gains to enforcement with the risk that more law (focused on threats) will increase the social costs of crime. It is likely, however, that threats are much more than a stepping-stone to (some) attempted crimes and then to (serious) crimes themselves.

Threats generate anxiety. Anxiety is for most people a function of the length of the time period from the application to the resolution of a stress. Note that the terminology is a bit confusing, or doubly interesting, because some threats are contained within concrete wrongs. Thus, ransom kidnapping is itself a threat to do something worse than abduction alone unless ransom is paid. The threat of ransom kidnapping is in large part a threat of a threat; costs are imposed at each stage, and in each something can go wrong in a way that increases the chance of a fatality or serious harm. Kidnapping offers a layered example of threats and their costs, but the analysis is simplified if there are fewer stages, and for this reason we set kidnapping aside and turn to arson or physical assault, where the criminal threatens one of these crimes in the hope of extracting a payment from the target.

A straightforward observation is that law penalizes threats qua threats, because a threat followed by a physical assault, for instance, is worse than the physical assault alone. The former produces anxiety.<sup>45</sup> It must often be the case, however, that the target prefers the threat, and indeed prefers a longer threat period even though it produces more anxiety, because the threat affords an opportunity for precaution taking. To be sure, the threat-maker is aware of this, but the point is that the threat-maker does not aim to make the target as miserable as possible but rather to extract something from the target that is of direct benefit to the threat-maker. In any event, criminal penalties need not be proportional to the harm the victim experiences, for they might be designed to be effective deterrents. Ironically, or even paradoxically, law might attach penalties to threats in order to deal with the extortionist who rarely if ever executes, but simply imposes anxiety in order to extract payment from targets who find these threats

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<sup>44</sup> Omri Ben-Shahar & Alon Harel, *The Economics of the Law of Criminal Attempts*, 145 U. PA. L. REV. 299, 331-32 (1996) (arguing that attempt is punished less severely to incentivize the perpetrator to withdraw).

<sup>45</sup> We do not dwell on the infliction of this emotional distress because, as the text shows, this distress is incidental to questions of credibility. Note, however, that the distress brought on by a threat is unlikely to be entirely offset by the relief experienced when the threat is not followed by execution.



credible. The extortionist who dangles the target over a bridge's railing and threatens to drop him unless the target pays for safety, might well jar the target into making a payment with this frightening experience. Even though the law will make dropping and murdering the target less costly to the criminal if it punishes the threat, it is surely sensible to punish the first step, or the threat, in order to deter extortionists who specialize in dangling.

#### CONCLUSION

Law ought to reduce the credibility of threats where patently criminal activity is planned, but in other settings the credibility of threats might be sensibly enhanced because of their signal value. It is possible that the information conveyed by threats is sufficiently valuable that some threats presently regarded as wrongful by law ought not to be so, but this seems unlikely. In any event, we have not abandoned the ready intuition that a threat is wrongful if it seeks to leverage a gain by warning that another act already regarded as wrongful by law will be administered unless the target complies with a demand. Famously, law makes blackmail actionable even though the eventual menace, such as the distribution of an embarrassing photograph, is not independently actionable.<sup>46</sup> Whether it does so to discourage the acquisition of information or items harmful to another or for other reasons,<sup>47</sup> the target of the threat must assess not only the likelihood that the threat-maker can and will carry through on his threat but also that he is secondarily credible, and will not repeat the threat or execute despite compliance. This assessment is largely independent of the question of whether the threat is itself actionable under law and indeed the question of whether it is socially undesirable.

A threat is more credible when its cost of execution is low, the benefit of its execution to the threat-maker is high, compliance will not bring on additional threats against the target, the threat-maker benefits from developing a reputation as a credible threat-maker, the threat-maker is able to proceed in stages so that its marginal cost of execution is eventually low, and the target's ability to lower the threat-maker's benefit or raise its costs is low. Law operates most easily on the first of these components. It can reduce threats, and the wrongs episodically committed in order to make the threatening process more profitable, attaching penalties to them and apprehending threat-makers so that the cost of execution is, and is perceived as, high. Correspondingly, it can increase the credibility of a good threat by charging the target, rather than the threat-maker, who goes along with the breach of threat.

Threats can be credible in the absence of law. This is unsurprising to students

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<sup>46</sup> Lindgren, *supra* note **Error! Bookmark not defined.**, at 670-71 (explaining that the “paradox of blackmail” is “that two separate acts, each of which is a moral and legal right, can combine to make a moral and legal wrong”).

<sup>47</sup> *Id.* at 672 (citing earlier theories that posit that blackmail is illegal because of the transaction itself, or because the law should protect privacy and reduce economic waste, and proposing a new theory focused on blackmail as harmful to third parties).

of contract law who know that thousands of mutual promises are kept every day even where there is no real prospect of legal intervention. Still, in the absence of a stable legal system, there are fewer mutual bargains, and more fraud and violence. Threats are not as important as promises, either because of self-help or because we are accustomed to governments that control the worst forms of violence, and so an economic and legal system can survive and even thrive without law's help in making good threats more credible. Most legal systems work to discourage anti-social threats, much as some attempted crimes are punished. But legal systems would probably survive if they completely disregarded threats. Our positive goal here has been to understand the components of credibility in a variety of settings. Our normative aim has been to advance the idea that good threats, or signals, can be made more credible, much as some good promises are made more believable and valuable with extant legal remedies.

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