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**IS THE LAW OF DEFAMATION AS IT RELATES TO  
PUBLIC OFFICIALS AND PUBLIC FIGURES  
ECONOMICALLY EFFICIENT?**

**Alain Sheer  
Asghar Zardkoohi**

This Article considers the effects on investigative effort and self-censorship of the constitutional limitations the Supreme Court has placed upon the common law of defamation as it relates to falsehoods defamatory of public officials and public figures.<sup>1</sup> These limitations replaced the strict liability regime of the common law with a regime based upon the actual malice liability rule. The Court intended for this transformation to reduce the extent of self-censorship caused by the common law's strict liability approach.

This article's analysis of the new law of defamation is based on two fundamental assumptions: the first, that publishers organize their activities in order to maximize profit and thus apply profit maximization principles in deciding how much effort to make in investigating the accuracy of statements published and whether to self-censor; the second, that the social objective of the new law of defamation is to balance First Amendment and reputational interests. The analysis first evaluates the consequences of the strict liability and actual malice liability regimes upon publishers' decisions to investigate accuracy and to self-censor publications that concern public officials and public figures, and then compares the decisions induced by each rule with the decisions which would balance the social interests.

## **I. AN OVERVIEW OF THE LAW OF DEFAMATION**

### **A. The Common Law**

Before *New York Times v. Sullivan*,<sup>2</sup> defamation lawsuits were decided under principles of common law rather than constitutional law.<sup>3</sup> These principles required the plaintiff to prove both that the defendant had published defamatory statements and that he had suffered the specific type of injury needed to establish that the form of the defamation alleged was actionable.<sup>4</sup> If it was so established, the plaintiff could recover

general, specific, and sometimes punitive damages. The common law of defamation recognized only truth and various privileges as defenses and did not allow the defendant to avoid liability by showing the absence of fault.<sup>5</sup> The common law rule was thus one of strict liability to the defendant.

Of the defenses available at common law the most important for the purpose of analyzing the present law of defamation is the privilege of fair comment. In most of the American jurisdictions which recognized it, the privilege of fair comment was interpreted as not excusing false and defamatory statements of fact.<sup>6</sup> The privilege of fair comment did not usually excuse falsehoods defamatory of either private individuals or public officials, and thus it represents the point of departure for the constitutional law of defamation.

On balance, then, the common law of defamation recognized and strongly favored the interest in protecting reputation. Under it defamatory falsehoods were not understood as contributing to the realization of other valid social objectives.

#### **B. The *Sullivan* Case and the Conflict Between the First Amendment and the Common Law of Defamation**

The Supreme Court first addressed the implications of the First Amendment upon the common law of defamation in the *Sullivan* case. The Court recognized a constitutionally based qualified privilege for the publication of defamatory falsehoods holding that the first amendment protects a publisher from liability for falsehoods defamatory of the official conduct of a public official unless the plaintiff proves by clear and convincing evidence that the statements were made with actual malice—that is, “with knowledge that [the statements were] false or with reckless disregard of whether [the statements were] false or not.”<sup>7</sup>

The tests announced in *Sullivan* and the Court’s discussion of them show its concern with balancing the competing interests implicated by the publication of statements critical of government. The Court recognized that, at the time the decision to publish is made, a statement criticizing government will often possess both a potential to injure reputation (because there is some probability it will prove to be false) and a potential to provide information valuable to society (because there is some probability it will prove to be true). The Court reasoned that the extent of self-censorship exercised by publishers under the prevailing liability regime determines the balance struck between these competing interests. On the one hand, even when publishers are granted immunity from the consequences of publishing false information, the First Amend-

ment interest in the publication of truthful statements is advanced, because society is not deprived of the benefits of true statements, whose publication might be deterred by a threat of liability.<sup>8</sup> On the other hand, increasing the extent of self-censorship benefits society, because it avoids the effects of injuries to reputation that would arise when statements that prove to be false and defamatory are published.

The Court balanced the injury to reputation against the social value derived from publishing statements that subsequently would prove to be true. It concluded that the strict liability rule causes too much self-censorship and deprives society of valuable, accurate information about government, but that a rule of absolute immunity for defamatory falsehoods would cause too little self-censorship and injure reputation unjustifiably. It therefore announced a rule to accommodate the First Amendment interest in encouraging criticism of government and the state's interest in protecting the reputation of individuals: a public official can recover for a defamatory falsehood about his official conduct only if he proves by clear and convincing evidence that the statement was made with actual malice.

### C. The Application of the Actual Malice Rule

The *Sullivan* Court did not have to decide, and in fact did not decide, "how far down into the lower ranks of government employees the 'public official' designation would extend for the purposes of this rule," and it did not "specify categories of persons who would or would not be included" or "the boundaries of the 'official conduct' concept."<sup>9</sup> That question was addressed in the line of cases that began with *Curtis Publishing Co. v. Butts*.<sup>10</sup> By holding in *Butts* that the actual malice rule applied in cases brought by public figures, not merely public officials, the Court expanded the First Amendment's ambit. In *Gertz v. Robert Welch, Inc.*,<sup>11</sup> the Court provided a test to distinguish public figures from private plaintiffs. The Court subsequently clarified this public figure test in *Time, Inc. v. Firestone*,<sup>12</sup> *Wolston v. Reader's Digest Association, Inc.*<sup>13</sup> and *Hutchinson v. Proxmire*.<sup>14</sup>

*Butts* and the companion case, *Associated Press v. Walker*,<sup>15</sup> dealt with statements about the conduct of people who—while not official—were of interest to the public. *Butts*, a nationally known football coach and athletic director at the University of Georgia, had allegedly participated in a conspiracy to fix a football game. He was not an employee of the State of Georgia, although he directed the university's athletic program. *Walker*, a private citizen, allegedly had led a violent crowd in opposition to the enrollment of a black student at the University of

Mississippi. The Court, while holding that falsehoods defamatory of public figures were protected by the First Amendment and determining that both Butts and Walker were public figures, nevertheless decided in favor of Butts. However, it did decide against Walker.

The initial premises justified the decision to expand the application of the actual malice rule to include cases brought by public figures. The first was that “[t]he guarantees for speech and press are not the preserve of political expression or comment upon public affairs. . .’ [and therefore] freedom of discussion ‘must embrace all issues about which information is needed or appropriate to enable the members of society to cope with the exigencies of their period.’ ”<sup>16</sup> The discussion of such issues is therefore protected by the First Amendment, even when the discussion concerns the actions of individuals who are not public officials. The second premise was that false and defamatory comments about such individuals, like falsehoods defaming public officials, are protected by the First Amendment because, as Justice Harlan explained, “a rational distinction ‘cannot be founded on the assumption that criticism of private citizens who seek to lead in the determination of . . . policy will be less important to the public interest than will criticism of government officials.’ ”<sup>17</sup> Chief Justice Warren implicitly characterized individuals “intimately involved in the resolution of important public questions” as private deciders of public policy.<sup>18</sup> In *Butts* the Court concluded that First Amendment protection extended to falsehoods defamatory of private individuals who involved themselves in the resolution of important public controversies.

The *Gertz* case arose when the family of an individual who had been murdered by a policeman retained the plaintiff to represent them in a civil action for damages. The defendant published an article which described the trial as part of a plan to create a national police force sympathetic to a communist dictatorship and falsely identified the plaintiff as a central figure in the plan. The Court announced that the principal issue of the case was whether a newspaper or broadcaster that publishes defamatory falsehoods about an individual who is neither a public official nor a public figure may claim a constitutional privilege against liability for the injury inflicted by those statements.”<sup>19</sup>

The *Gertz* Court held that the actual malice liability rule must be applied in defamation cases brought by public officials and public figures, while in state actions fault-based liability rules would be used to resolve cases brought by private plaintiffs. The meaning of the public figure test is of great importance because in conjunction with the public official test it limits the ambit of the First Amendment to which the actual malice rule applies. The Court described three classes of public persons: all-

purpose, limited-purpose, and involuntary. Of these it considered the limited-purpose public figure category to be the largest and most important.<sup>20</sup> Limited-purpose public figures "thrust themselves to the forefront of particular public controversies in order to influence the resolution of the issues involved," and can be identified by "the nature and extent of [the] individual's participation in the particular controversy giving rise to the defamation."<sup>21</sup> The Court thus established voluntariness and public controversy as the elements of the limited-purpose public figure test. It did not, however, explain fully whether a public controversy is anything interesting to the public or whether voluntariness and public controversy are independently necessary characteristics of limited-purpose public figures.

The meaning and independent significance of the public controversy and voluntariness elements of the limited-purpose public figure test announced in *Gertz* were partially clarified in the *Firestone*, *Wolston*, and *Hutchinson* cases. The *Firestone* case concerned a defamatory falsehood about the ground on which a divorce had been granted. Although it did not settle the matter, the Court suggested that the respondent was not a public figure and that public controversy and voluntariness constitute independent elements of the limited-purpose public figure test.

The *Wolston* case arose from a book which falsely described the petitioner as a Soviet agent who had been indicted for espionage and then convicted of contempt. The Court held that voluntariness and public controversy were separate and independent elements of the public figure test. It found that the requisite voluntariness did not exist because the petitioner had not made an affirmative effort to persuade others to a particular viewpoint: he had "never discussed the matter with the press and [had] limited his involvement to that necessary to defend himself against the contempt charge."<sup>22</sup>

The *Hutchinson* case arose when the government agency that had sponsored the petitioner's scientific research was awarded Senator Proxmire's "Golden Fleece of the Month Award." The Court held that the petitioner was not a public figure, and by so holding it clarified the meaning of the public controversy element of the limited-purpose public figure test. *Hutchinson* did not place this controversy within the meaning of the public figure test because a concern about public expenditures was simply too broad to be a *Gertz* controversy. The Court also concluded that the requisite degree of voluntariness was absent.

Taken together *Gertz*, *Firestone*, *Wolston*, and *Hutchinson* suggest that: (1) voluntariness and public controversy are separate and independent elements in the limited-purpose public figure test; (2) the universe of public controversies is smaller than the universe of topics that are

newsworthy or of general public interest; and (3) the requisite degree of voluntariness exists when an affirmative effort to persuade others has been made.

In sum, under the new law of defamation the plaintiff's status as a public official, public figure, or private plaintiff determines the rules that may be used to decide both liability and the type of damages that may be recovered. Public officials and public figures must overcome the actual malice liability standard because, unlike private figures, they voluntarily involve themselves in events at least arguably related to self-government. Public officials and public figures can recover compensatory and noncompensatory damages upon clear and convincing proof of actual malice. In keeping with the Court's requirement that the states apply some type of fault-based rule in cases brought by most private plaintiffs,<sup>23</sup> various states now decide these cases using simple negligence, negligence-actual malice, gross negligence, or actual malice rules.<sup>24</sup> Private plaintiffs can not recover noncompensatory damages absent proof of actual malice, and even then such recoveries can be forbidden at state option.

## **II. EFFICIENCY UNDER THE STRICT LIABILITY AND ACTUAL MALICE RULES**

In developing the constitutional privilege for defamatory falsehoods, the Court addressed the question of the proper balance between the interest raised by the First Amendment and the state's interest in protecting reputation. It determined that the common law rule of strict liability over-protected reputations and caused too much self-censorship of probabilistic statements relevant to self-government. To provide additional "breathing space" the Court required that cases brought by public officials and public figures be decided under the actual malice liability rule instead of the strict liability rule. The question addressed here is whether the replacement of the strict liability rule with the actual malice rule changed the balance between the competing interests to society's advantage.

There are three steps to answer this question. The first, which is considered in subsection A, is to explain the basic economic model and the implications for it of the constitutional privilege for falsehoods defamatory of public officials and public figures. The second, discussed in subsection B, is to determine, using the economic model, the effects of the common law strict liability regime upon both private decisions to investigate accuracy and publish or self-censor and the balance achieved

between the competing interests. The third step is to determine the effects of the actual malice rule upon private decisions and upon social efficiency.

### A. The Economic Model and the Implications of Constitutional Privilege

#### 1. The Economic Model<sup>25</sup>

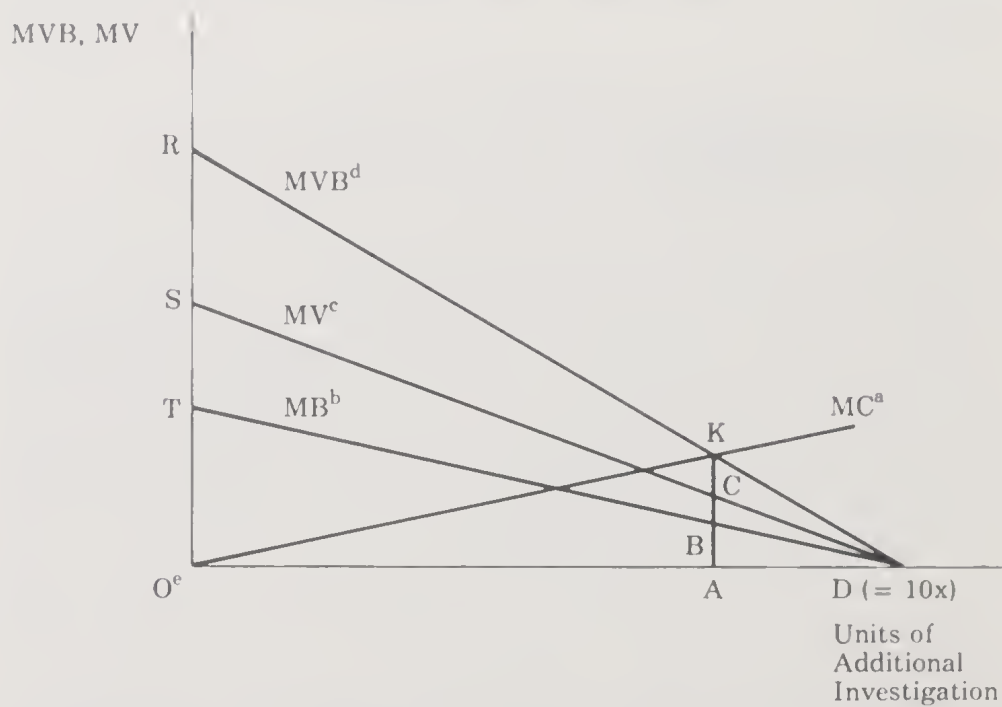
A publisher's decision to investigate and publish or to self-censor a statement that he is aware may be defamatory depends upon the calculus of expected profit maximization. In this model, the publisher's expected profit is the anticipated revenue to be earned from publishing it (the product of the probability the statement is true and its market value if it is true, less the cost of investigating its accuracy and less the expected cost of the damages that would accrue if it were not, and a suit resulted and the publishers were judged liable).

By hypothesis, each element of the publisher's calculation depends on the extent of his investigation into accuracy. We assume that there exists a production function relationship between the level of investigative effort and the probability the statement is true such that increments in investigative effort increase the probability of truth and reduce the probability of falsity.<sup>26</sup> Such increments are costly, but they benefit the publisher, because they increase the market value or revenue to be derived from publication and they reduce the expected cost of liability.

In principle, to maximize expected profit the publisher must evaluate each of the elements of the profit equation at the margin.<sup>27</sup> Thus, once he has notice of a statement's defamatory potential, he maximizes profit by undertaking additional investigation until the marginal cost of further investigating accuracy equals the sum of the increase in value and the decrease in the cost of liability expected to result from the increase in the probability of truth associated with further investigation. The level of the profit the publisher would earn if he were to publish after undertaking the optimal level of investigation determines whether he will actually provide that level of investigation and publish.<sup>28</sup>

Functions representing these elements of the profit equation are depicted geometrically in figure 8.1. There, the incremental or marginal cost of additional units of investigation into accuracy is represented by the upward sloping *MC* function.<sup>29</sup> Whether committing additional resources to investigating accuracy will reduce the expected cost of liability depends partially upon the prevailing liability rule: under a strict liability rule this kind of marginal benefit is depicted by the *MB* function in figure 8.1.<sup>30</sup> Additional efforts at investigation are assumed to increase

FIGURE 8.1: The Basic Model



a. The  $MC$  function measures the change in the total cost of investigation that occurs when the publisher changes the level of additional investigation by one unit.

b. The  $MB$  function measures the change in the total expected cost of liability when the publisher changes the level of investigation by one unit, or changes the probability of truthfulness by the amount associated with a one-unit change in the level of investigation, and is subject to a strict liability limited to actual damages rule.

c. The  $MV$  function measures the change in the total expected value of publication that occurs when the publisher changes the level of investigation by one unit, or changes the probability of truthfulness by the amount associated with a one-unit change in the level of investigation.

d. The  $MVB$  function is the vertical addition of the  $MB$  and  $MV$  functions. It therefore measures the change in the sum of the total expected cost of liability and the total expected value of publication when the publisher, facing a strict liability limited to actual damages rule, changes the level of investigation by one unit, or changes the probability of truthfulness by the amount associated with a one-unit change in the level of investigation.

e.  $O$  represents the point at which the publisher has notice of a statement's defamatory potential and can begin to act to avoid liability for a defamatory falsehood.

the value expected from publication by reducing the probability of a statement being false.<sup>31</sup> This kind of marginal benefit is depicted by the  $MV$  function in figure 8.1. Finally, under the strict liability rule the sum of the marginal benefits function is the vertical summation of the  $MB$  and  $MV$  functions. In the figure, the sum of the marginal benefits function is labelled  $MVB$ .



Under a rule of strict liability the investment in additional investigation that will maximize expected profit is identified by the intersection of the *MC* and *MVB* functions. In the figure, the optimal level of additional investigation is *A* units when the rule is one of strict liability.

Establishing the level of additional investigation that will maximize profit does not, however, ensure that the publisher will in fact investigate to that extent and publish the statement: undertaking that level of investigation merely means either that the profit expected from publishing will be maximized or that the loss expected will be minimized. Because the publisher can avoid such a loss by not publishing, the next step in deciding whether to publish or not is to calculate the level of profit expected were the optimal level of additional investigation to be undertaken. The outcome of that calculation, which is simply expected revenue less the sum of the cost of investigation and the expected cost of unavoided liability, can also be determined using the functions depicted in the figure. There expected revenue is the area beneath the *MV* function to the left of *A* units of investigation, or area *OSCA*.<sup>32</sup> The cost of the optimal amount of additional investigation is the area beneath the *MC* function to the left of *A* units of investigation, or area *OKA* in figure 8.1. Under the strict liability rule, the expected cost of unavoided liability is the area beneath the *MB* function to the right of *A* units of additional investigation, or area *ABD*. Thus, when the optimal investigation is undertaken expected profit is area *OSCA* less the sum of areas *OKA* and *ABD* under the strict liability rule. If expected profit so calculated is positive, the optimal investment in investigation will be made and the statement will be published; if it is negative, the investigation will not be made and the statement will not be published. As depicted in figure 8.1, expected profit is positive, so publication will occur.

## 2. The Implication of the Constitutional Privilege for the Maximization of the Social Interest

The social objective in regulating the publication of statements about which there is some doubt is to maximize the net social benefit derived from publishing such statements. Achieving this objective involves balancing the expected value of publication to society and the expected cost of damage to reputation on the one hand with the cost of investigation on the other. The analytical procedure by which publishers decide the optimal extent of investigation and whether to publish or not is also the method by which society determines both the extent of investigative effort and of self-censorship which is optimal from its perspective. Thus, net expected social benefit will be maximized when published statements

are beneficial and embody the level of additional investigation consistent with the equality of marginal cost and the sum of the expected marginal benefits to society.

It follows that when the sum of the marginal benefits function and the marginal cost function that direct private decisions about additional investigation and self-censorship are also the relevant functions from society's perspective, publishers will in their own self-interest reach decisions that maximize the net social benefit. There is no difference between the private and social marginal cost of additional investigation, and, under a strict liability rule, there is no difference between the private and social marginal benefit arising from reductions in the expected cost of liability. The constitutional privilege regarding defamation of public officials and public figures, however, implies that in such cases there is an important difference between the marginal social value of additional investigation and the marginal value of additional investigation to the publisher.

The Court distinguishes public officials and public figures from other public figures and from other plaintiffs within the ambit of the First Amendment because it recognizes that the marginal social value and the marginal private value of statements at issue in cases brought by public officials and public figures, but not in cases brought by other plaintiffs, almost always will differ. Thus:

[t]he Amendment has a "central meaning"—a core of protection of speech without which democracy cannot function, without which, in Madison's phrase, "the censorial power" would be in the Government over the people and not "in the people over the Government." This is not the whole meaning of the Amendment. There are other freedoms protected by it. But at the center there is no doubt what speech is being protected and no doubt why it is being protected.<sup>33</sup>

By requiring public plaintiffs to be advocates of public policy positions, that is, to be officially or voluntarily involved in the resolution of important public controversies, the Court identified the class of individuals about whom publications are likely to implicate what economic theory describes as an externality issue.<sup>34</sup>

Publications that concern public officials and public figures are usually relevant to self-government and, if true, likely to contribute to government decisions that benefit even those from whom publishers cannot obtain compensation. In such cases publishing probabilistic statements provides an expected external benefit to society.

On the other hand, when false and acted upon as though true, such publications impose an external cost upon society. Such an external cost

arises, however, only when the underlying publication stands unchallenged. When defamatory falsehoods are challenged, society is put on notice not to treat them as true, which, one would expect, would call into play investigative forces originating in the news market. By noting that public officials and public figures possess meaningful access to the means of counterargument<sup>35</sup> the Court has implicitly indicated its willingness to rely on challenge and such corrective forces to forestall the imposition of external costs upon society. It is therefore unlikely that the publication of falsehoods defaming public officials or public figures will impose external costs upon society.

From these arguments, it can be seen that the publication of probabilistic statements concerning public figures and public officials are likely to contribute to the realization of important external benefits but not to the realization of external costs. The private incentive to publish may be affected adversely by the incidence of this self-government external benefit. The private profit expected from publishing a statement that implicates that benefit is less than the expected benefit of publishing it to society, even when—as we assume—the publisher can extract the full value of the publication from those who purchase it. In such cases, there will be more self-censorship than would be ideal from society's perspective, even before considering the implications of fault-based liability regimes.

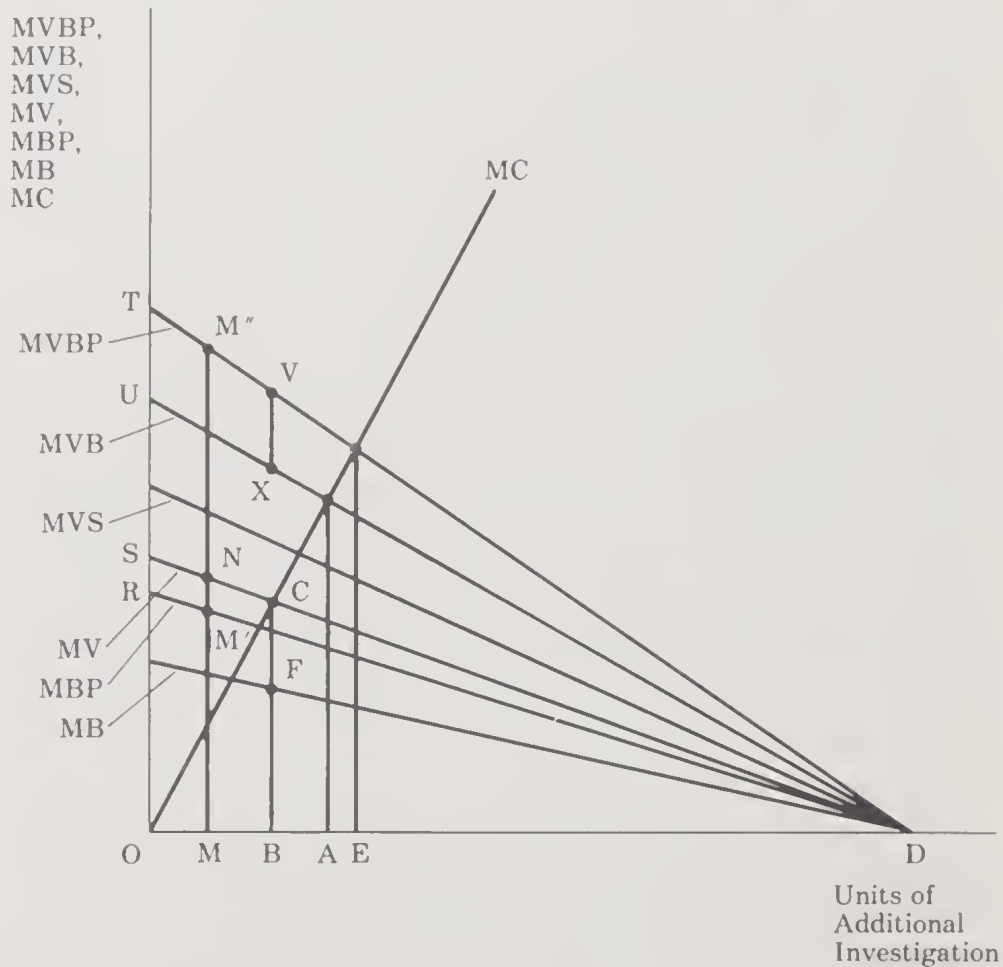
### **B. The Social Efficiency of the Strict Liability Rule When the Self-Government External Benefit Is Implicated**

The strict liability rule is the appropriate baseline for assessing whether the imposition of the actual malice regime advanced the objective of maximizing net social benefit. Thus, it is necessary to evaluate the efficiency consequences of the strict liability rule with respect to publications that implicate the self-government external benefit. The efficiency of that rule is developed in two steps, making use of the economic model in the form depicted in figure 8.2. The first addresses publishers' responses and social efficiency of a strict liability rule that authorizes the recovery of only compensatory damages, and the second step considers complications that arise when, as under the common law, noncompensatory damages may be recovered.

#### **1. Efficiency Under a Strict Liability Rule With Only Compensatory Damages**

In figure 8.2 the *MC*, *MB*, *MV* and *MVB* functions represent the marginal cost of additional investigation, the marginal benefit from reduc-

FIGURE 8.2: Strict Liability and Actual Malice



tions in the expected cost of actual injury, the marginal benefit due to increases in the expected value of publication to the publisher, and the sum of the publisher's marginal benefits function. The increment in the expected value of publication to society attributable to additional investigative efforts is labeled the *MVS* function. The *MVS* function is the sum of the *MV* function and the expected value of the external benefit. The function labeled *MVBP* is the sum of the marginal benefits function for society.

As in figure 8.1, when the rule is one of strict liability, an investment of *A* units of additional investigation maximizes the profit expected by the publisher, since at that level of additional investigation the *MC* and *MVB* functions intersect. That level of additional investigation, however, is not optimal from society's perspective because there the sum of society's marginal benefits function—the sum of the *MVS* and *MB*

functions or the *MVBP* function—lies above the *MC* function. From society's perspective, *E* units of additional investigation maximizes net social benefit since at that level of additional investigation the *MC* and *MVBP* functions intersect. Thus, statements that implicate the self-government external benefit and that would be published under the strict liability rule will not be investigated as much as society would like. When only compensatory damages can be recovered the strict liability rule will therefore not maximize the net social benefit derived from statements whose publication it does not prevent because the publisher can not appropriate the value of the external benefit.

It is, however, also possible that under such a rule statements whose publication would advance the social interest will not be published. This possibility can be evaluated without resorting to geometric analysis. Because the publisher can not appropriate the value of the external benefit, in at least some circumstances the profit he expects from publication will be insufficient to make publishing worthwhile, even though society would prefer publication because it does realize the expected external benefit. In such cases, the strict liability rule will induce too much self-censorship of statements that may not be accurate.

It seems, therefore, that a strict liability rule authorizing the recovery of only compensatory damages will be inefficient: from the social point of view such a rule will call forth both too much self-censorship and too little investigation into those probabilistic statements that are published under it.

## **2. Efficiency Under a Strict Liability Rule With Noncompensatory Damages**

To the extent that noncompensatory damage awards alter the values of the factors that guide private decisions to investigate accuracy and publish or self-censor, private decisions reached under a strict liability rule—one authorizing the recovery of noncompensatory damages—may differ from decisions made under actual damage limited strict liability rule. In principle, when noncompensatory damage awards are expected the marginal benefit of additional investigation, in the form of reductions in the expected cost of the publisher's liability, is greater than it would be if only actual damages could be recovered. Assuming that noncompensatory damages are equal to the value of the external benefit,<sup>36</sup> the function that represents the marginal benefit of additional investigation, including noncompensatory damages, is the *MBP* function in figure 8.2. It is the vertical summation of the *MB* function and expected noncompensatory damages. The sum of the publisher's marginal benefits function is therefore the function of *MVBP* in figure 8.2.

Under a strict liability rule authorizing the recovery of noncompensa-

tory damages, the level of investigation that maximizes the profit expected by the publisher occurs where the *MC* and the *MVBP* functions intersect. In figure 8.2, the privately optimal investment in additional investigation is therefore *E* units. As the preceding subsection explained, *E* units of additional investigation also maximize net social benefit. Therefore, when the threat of noncompensatory damages does not deter publication, the ideal regime from society's perspective is a strict liability rule under which noncompensatory damage awards are equivalent in amount to the external benefit expected from the publication in question.

The threat of noncompensatory damage awards may, however, deter socially desirable publications. This is because the publisher can not extract for himself the expected value of the external benefit, with the result that expected profit from publishing may be negative when the net social benefit of publishing is positive. In such cases a strict liability regime under which noncompensatory damages may be recovered fails to maximize net social benefit: it induces too much self-censorship, since as an incentive to publish unappropriated expected value is not the same as noncompensatory damages paid.

In summary, the introduction of noncompensatory damage awards equal in value to the expected external benefit does not make the strict liability rule efficient. That rule advances the social interest by inducing the proper amount of investigation into accuracy of those publications which it does not deter, but it also deters some publications which society would prefer to be published. It therefore seems unlikely that the common law which preceded *Sullivan* was efficient. That approach did not generally distinguish between publications that implicated the external benefit and those that did not, and even if it had, it provided no mechanism to avoid undersirable self-censorship. On this analysis the Court's conclusion that the common law approach provided insufficient "breathing room" seems correct. Of course this conclusion does not mean that the Court advanced the social interest by imposing the actual malice rule in the place of the common law regime.

### **C. The Social Efficiency of the Actual Malice Rule When the Self-Government External Benefit Is Implicated**

We now use the same economic model as in our evaluation of the consequences of the strict liability regimes to determine the efficiency consequences of the actual malice rule. The first step is to establish the correspondence between actual malice, which the *Sullivan* Court described as publishing with knowledge of falsity or with reckless disregard

for truth or falsity,<sup>37</sup> and investment in investigation. The second step is to evaluate the private and social consequences of the actual malice rule.

### 1. Actual Malice in the Context of the Economic Model

The Court has explained that reckless disregard exists when a publisher has serious doubts about the accuracy of a statement but publishes it in spite of those doubts. Its holding in *Lando v. Herbert*<sup>38</sup> established that serious doubts can be inferred from the extent and results of the publisher's investigation, so that actual malice exists when the evidence of the publisher's investigation makes clear that the publisher's state of mind was inappropriate. Actual malice liability exists when, from his own perspective, the publisher's investigation was insufficient; it does not exist merely because the publisher should have had serious doubts about a statement's accuracy. The behavioral consequences of the actual malice rule can therefore be evaluated in the context of the economic model explicated in preceding subsections.

The consequences of the actual malice rule for investigation into accuracy and self-censorship can, however, be evaluated only after the meaning of actual malice in terms of the level of investigation at which liability is avoided has been established. Although the location of that threshold can not be identified with precision it is clear that it entails less investigation than is necessary to avoid liability under the negligence rule: in *Sullivan*, for example, the Court held that the *New York Times* had at most been negligent in publishing the advertisement defamatory of Sullivan, and that was not enough to make out actual malice.<sup>39</sup> The threshold of actual malice liability in terms of the level of investigation is therefore lower than under the negligence rule.

The comparative position of the investigative threshold of liability under alternative liability rules is an important determinant of the publisher's behavior under such rules. It determines the shape of the publisher's expected marginal benefit function, because it marks the level of additional investigation at which the marginal benefit in the form of reductions in the expected cost of liability becomes zero. Thus the expected marginal benefit function for the publisher, but not for society, is sensitive to the prevailing liability rule, and because the expected marginal benefit function is an element in the sum of the publisher's marginal benefits function, the shape of that aggregate function also is determined by the prevailing liability rule. It is in this way that the actual malice rule affects publisher's decisions whether to investigate and publish or self-censor. These decisions and the resulting social efficiency are discussed in the next subsection.

## 2 The Efficiency of the Actual Malice Rule

The functions depicted in figure 8.2 facilitate analysis of the behavioral and efficiency consequences of the actual malice rule. Except for two functions that are affected by the liability threshold of the actual malice rule, all the functions in figure 8.2 and the assumptions that underlie them remain as previously discussed. The first of the new functions is the publisher's expected marginal benefit function under the actual malice rule. Under that rule the benefit expected from further investigation is zero once the liability threshold has been reached or surpassed. That threshold lies below the negligence threshold, which occurs at the intersection of the  $MC$  and  $MB$  functions in figure 8.2,<sup>40</sup> and it is denoted as  $M$  units of additional investigation in figure 8.2. The publisher's expected marginal benefit function under the actual malice rule is therefore coincident with the  $MBP$  function for fewer than  $M$  units of additional investigation, and thereafter the marginal benefit of further investigation becomes zero. The publisher's expected marginal benefit function is line segment  $KMMD$  in figure 8.2. The second new function is the sum of the publisher's marginal benefits function. In figure 8.2 it is line segment  $TMND$ .

The level of additional investigation that maximizes the publisher's expected profit occurs at the intersection of the  $MC$  and the sum of the publisher's expected marginal benefits function under the actual malice rule, which is line segment  $TMND$ . Under the actual malice rule the publisher therefore maximizes profit by investing in  $B$  units of additional investigation. Although this level of additional investigation satisfies the actual malice standard, it clearly fails to maximize net social benefit, which, as discussed in preceding subsections, is maximized by  $E$  units of additional investigation. On this analysis, the actual malice rule induces publishers to investigate those statements that are published less extensively than society desires. Because  $E$  units of additional investigation would be provided by a publisher facing a strict liability rule under which noncompensatory damages may be recovered, it seems clear that with respect to those statements that would be published under either rule the actual malice rule is the less desirable rule.

There remains, however, the question of the extent of self-censorship induced by the actual malice rule. As depicted in figure 8.2, the publisher will find it profitable to publish under the actual malice rule, since expected profit equals area  $SCBO$  (the revenue expected from publishing) less the sum of area  $DCB$  (the cost of  $B$  units of additional investigation) or area  $SCO$  (which is positive). In such circumstances, however, society preters self-censorship, because the net expected social benefit derived from publishing is area  $SCBO$  (the revenue expected by the



publisher), plus area  $TVXU$  (the expected value of the external benefit) less area  $BFD$  (the expected cost of unavoided liability), and less area  $OCB$  (the cost of  $B$  units of additional investigation), which under the conditions depicted in figure 8.2 is negative. Thus, in some circumstances the actual malice rule induces too little self-censorship.

The actual malice rule is thus an efficient rule under the postulated circumstances. It induces publishers to invest less in ascertaining the accuracy of published statements than is socially optimal. As a result, under the actual malice rule the probability of truth of those statements that are published will be undesirably low. In addition, the actual malice rule also induces publishers to engage in too little self-censorship. It is therefore inefficient on both counts.

## CONCLUSION

The *Sullivan* case and its progeny have transformed the law of defamation. Where there formerly had been a rule of strict liability under which compensatory and noncompensatory damages could be recovered there is now a rule of actual malice which permits public officials and public figures to recover compensatory and noncompensatory damages. This article has analyzed the consequences of this transformation on the decisions of publishers and on the achievement of efficiency. It has treated both private decisions to investigate and publish probabilistic statements and the balance of the social objectives as economic problems. The publisher's objective was taken to be expected profit maximization, while the social objective was to balance the interest in publishing information relevant to self-government against the interest in protecting reputation. The impact of liability rules upon the achievement of these objectives was analyzed using an economic model which assumed that: (1) publications concerning public officials and public figures implicate an important external benefit; (2) publishers extract the full value of their publications from those who buy them; (3) the value of such publications to purchasers depends upon their expected accuracy; (4) investigating accuracy is costly; (5) noncompensatory or punitive damage awards equals the value of the external benefit implicated by such publications; and (6) the liability rules do not differ significantly in terms of administrative and other costs.

Under these circumstances neither rule maximizes net social benefit: when neither rule deters publication the actual malice rule induces too little investigation into accuracy while the strict liability rule induces the ideal investigative effort, but the actual malice rule also induces too little

self-censorship while the common law approach induces too much. Thus the new law of defamation probably substitutes an imbalance in favor of publication for an imbalance in favor of reputation. This may be a useful second-best solution, because of the importance of the self-government external benefit implicated by publications concerning public officials and public figures.

## NOTES

1. The concepts and arguments presented in this Article are derived from, and explained in much greater detail in Sheer & Zardkoohi, "An Analysis of the Economic Efficiency of the Law of Defamation," 80 *NW. U. L. Rev.* 364 (1985).

2. 376 U.S. 254 (1964).

3. The description of the common law presented here is both brief and necessarily general, and it does not reflect the variations in the law of defamation among the states. See, e.g., Eaton, "The American Law of Defamation Through *Gertz v. Robert Welch, Inc.* and Beyond: An Analytical Primer," 61 *Va. L. Rev.* 1349, 1351-63 (1975). The purpose of this description of the common law is to provide a basis for evaluating how the new law of defamation changed the balance of interests.

4. See W. Prosser, *Law Of Torts* 751-64 (4th ed. 1971) [hereinafter Prosser]. To be defamatory, a statement had to injure the plaintiff's reputation or discourage others from associating with him. *Id.* at 739-44. The publication could be made negligently or intentionally. *Id.* at 774-76. Those to whom the statement was published must have interpreted it as referring to or being "of and concerning" the plaintiff. *Id.* at 749-51. We assume all elements of the cause of action here.

5. *Id.* at 776-96.

6. Sixteen states included within the privilege false statements of fact. C. Lawhorne, *Defamation and Public Officials* 152-65, 173 (1971).

7. *Sullivan*, 376 U.S. at 279-80.

8. See *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 340 (1974).

9. *Sullivan*, 376 U.S. at 283 n.23

10. 388 U.S. 130 (1967).

11. 418 U.S. 323 (1974).

12. 424 U.S. 448 (1976).

13. 443 U.S. 157 (1979).

14. 443 U.S. 111 (1979).

15. 388 U.S. 130 (1967), reported *sub nom.* *Curtis Publishing Co. v. Butts*.

16. *Id.* at 147 (quoting *Time, Inc. v. Hill*, 385 U.S. 374, 388 (1967) and *Thornhill v. Alabama*, 310 U.S. 88, 102 (1940)).

17. *Id.* at 147-48 (quoting *Pauling v. Globe-Democrat Publishing Co.*, 362 F.2d 188, 196 (8th Cir. 1966), *cert denied*, 388 U.S. 909 (1967)).

18. *Id.* at 164 (Warren, C. J., concurring).

19. *Gertz*, 418 U.S. at 332.

20. The all-purpose public figure class included individuals who "occupy positions of such persuasive power and influence that they are deemed public figures for all purposes." *Id.* at 345. But the Court intended this class to be small since "[a]bsent clear evidence of general fame or notoriety in the community, and pervasive involvement in the affairs of

society, an individual should not be deemed a public personality for all aspects of his life." *Id.* at 352. With respect to involuntary public figures, the Court noted that "[h]ypothetically, it may be possible for someone to become a public figure through no purposeful action of his own, but the instances of truly involuntary public figures must be exceedingly rare." *Id.* at 345. Thus we consider in detail only the limited-purpose public figure class.

21. *Id.* at 352.

22. *Wolston*, 443 U.S. at 167.

23. *Gertz*, 418 U.S. at 346–48.

24. The simple negligence rule is exemplified by *Stone v. Essex County Newspapers Inc.*, 367 Mass. 849, 330 N.E.2d 161 (1975). *Taskett v. King Broadcasting Co.*, 86 Wash. 2d 439, 546 P.2d 81 (1976) is an example of the bifurcated rule approach, which involves a combination of the negligence and actual malice rules. The application of the gross negligence rule is exemplified by *Chapadeau v. Utica Observer-Dispatch, Inc.*, 38 N.Y.2d 196, 341 N.E.2d 569, 379 N.Y.S.2d 61 (1975). Finally, *Aafco Heating and Air Conditioning Co. v. Northwest Publications, Inc.*, 162 Ind. App. 671, 321 N.E.2d 580 (1974), *cert. denied*, 424 U.S. 913 (1976) represents the actual malice rule approach.

25. Economic theory characterizes the empirical settings in which injuries occur as either alternative-care or joint-care. *See, e.g.*, Landes & Posner, "The Positive Economic Theory of Tort Law," 15 *Ga. L. Rev.* 851, 880–83 (1981). The setting which is appropriate in a given case depends upon the abilities of the parties to the injury to avoid the injury. In joint-care situations efficiency requires that both parties make appropriate efforts to avoid injury, while in alternative-care situations efficiency requires that only one party attempt accident-avoidance. The difference is analytically significant, because only in the alternative-care setting can simple demand and supply functions be used to evaluate the efficiency of alternative liability rules.

We evaluate the efficiency consequences of the law of defamation using an alternative-care economic model. Both the Courts and commentators, at least by implication, suggest that defamation is properly analyzed in the context of such a model. In *Curtis Publishing Co. v. Butts*, for example, Justice Harlan began his discussion of liability rules by noting that "the basic theory of libel has not changed [over time] and words defamatory of another are still placed 'in the same class with the use of explosives or the keeping of wild animals.'" 388 U.S. at 152 (citation omitted). But he did not recognize assumption of risk or voluntary involvement as affirmative defenses, even though assumption of risk is generally a complete defense in cases involving wild animals and explosives. Moreover, some commentators have noted that the assumption of risk defense available in cases involving wild animals and explosives should be interpreted as a method to identify alternative-care cases in which the plaintiff can avoid the accident at lower cost than the defendant. We therefore analyze the law of defamation using an economic model in which the defendant rather than the plaintiff is the party able effectively to avoid injury to reputation.

26. We assume that additional investigation increases the probability of truth and decreases the probability of falsity at a decreasing rate. Thus, successive increments in investigation increase the probability of truth and reduce the probability of falsity by successively smaller amounts.

27. An economic problem is usually characterized as either an equilibrium problem or as an optimization problem. Profit maximization is an optimization problem. "Mathematically, the process of optimization can be formulated as finding a maximum (or minimum) of some desired (or undesired) criterion. . . . Economists have devised a variety of methods for optimization, turning upon the idea of 'marginal' quantities. . . ." J. Hirshleifer, *Price Theory and Applications* 20–21 (2d ed. 1984).

Incremental or marginal analysis concerns the change in a dependent variable attribut-

able to a one-unit, or marginal, change in an independent variable. For example, since profit is defined as total revenue less total cost, both of which are dependent upon the level of output, profit is maximized when the last unit of output produced adds as much to cost (marginal cost) as it does to revenue (marginal revenue).

28. The expected profit calculation which determines publisher responses to liability rules reflects only the extent of additional investigation undertaken after the publisher has notice of a statement's defamatory potential, because only when the publisher has such notice does he have an opportunity to take appropriate measures to avoid injuring reputation. This is the meaning of the Court's announcement in *Gertz v. Robert Welch, Inc.*, 418 U.S. 323 (1970), that in defamation cases its rules of liability apply only when the publication at issue "makes substantial danger to reputation apparent." *Gertz*, 418 U.S. at 348.

29. The marginal cost of additional investigation is the change in the total cost of investigation when one more unit of investigation is committed to determining accuracy. In figures 8.1 and 8.2, the total cost of a particular level of additional investigation is the area beneath the *MC* function to the left of that level of investigative effort.

30. We assume that additional investigation increases the probability of truth (and reduces the probability of falsity), but at a decreasing rate. Thus, successive increments in investigative effort increase the probability of truth (and reduce the probability of falsity) by successively smaller amounts. As a result, when the publisher cannot avoid liability, as is the case under the strict liability rule, additional investigation reduces the expected cost of liability by successively smaller amounts. The *MB* function depicts this relationship. It is drawn so that at *D* units of additional investigation the probability of falsity is zero. When fewer than *D* units of additional investigation are undertaken, the area under the *MB* function to the left of the investigative effort made is the avoided expected cost of liability, while the area to the right of it is the unavoided expected cost of liability.

31. We assume that purchasers value accuracy. By increasing at a decreasing rate the probability of truth increments in investigation therefore also provide successively smaller increments in the revenue expected by publishers. The *MV* function in figures 8.1 and 8.2 depicts this relationship.

32. For analytical simplicity and also because publishers frequently possess substantial market power we assume that publishers can extract from purchasers the full value of their purchases. The total revenue the publisher therefore expects to earn from undertaking additional investigation is the area beneath the *MV* function to the left of the additional investigation undertaken.

33. Kalven, "The New York Times Case: A Note on 'The Central Meaning Of The First Amendment,'" 1964 *Sup. Ct. Rev.* 191, 208.

34. External costs and benefits are the consequences of "the decisions of some economic agents . . . [which] affect other economic agents in ways that do not set up legally recognized rights of compensation or redress. . . ."

"Consider pollution. An upstream use of water may degrade water quality, for example, chemical pollution may reduce potability for downstream consumers, or heat pollution may make the river less effective for down-stream cooling." *Supra* note 32, at 484.

35. Public persons "usually enjoy significantly greater access to the channels of effective communication and hence have a more realistic opportunity to counteract false statements than private individuals." *Gertz*, 418 U.S. at 344. *See also Butts*, 388 U.S. at 154-55 (the application of the actual malice rule in cases brought by public officials and public figures and of a rule more protective of reputation in other cases can be justified by considering the differences between these plaintiff classes with respect to official position or voluntary involvement and access to the means of counterargument).

36. Because there is no empirical evidence relating the level of punitive damages available under either rule to the expected value of the external benefit, the analysis advanced here can proceed only if such a relationship is assumed. Our assumption that punitive damages equal the value of the external benefit simplifies the analysis, and it provides a basis for conclusions about efficiency should a different, systematic relationship be discovered.

37. *Sullivan*, 376 U.S. 254 at 279–80.

38. 441 U.S. 153, 157 n. 2, 177 (1979).

39. See *Sullivan*, 376 U.S. at 280.

40. See Landes & Posner, *supra* note 30, at 876, 892–903.