

VI. Theory

The Coase Theorem and Divorce

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In honor of Christoph Engels's career long habit of revisiting, reevaluating, and often extending classic papers in law and economics and empirical legal studies, this paper revisits Mnookin and Kornhauser's 1978 paper's insight that divorce bargaining takes place "in the shadow of the law" and evaluates it through the lens of the recent advances in our understanding of the Coase theorem and bargaining in the shadow of the law more generally. The Coasian prediction that private bargaining yields efficient and durable outcomes is at odds with the observed fragility of divorce settlements, where custody, support, and visitation orders are frequently reopened for modification. Using evidence from the Los Angeles Superior Court and extending the divergent expectations model, I examine how the limits of the Coase theorem map onto family law. Bargaining theory limits, interdependent utilities (altruism and spite), transaction costs, commitment problems, legal limits rooted in third-party rights, and agency problems from lawyer incentives all narrow the settlement range and, in some cases, make durable agreements less likely. These extensions suggest why divorce settlements often unravel and why family courts devote substantial resources to post-judgment modification.

A. Introduction*

It has been almost fifty years since the publication of Mnookin and Kornhauser's seminal article, *Bargaining in the Shadow of the Law* (Mnookin and Kornhauser, 1978). Their essay was the first to apply what has come to be known as the divergent expectations model to divorce and family law. Building on the high rate of stipulated judgments (settlements) and the divergent expectations model of pretrial bargaining, the paper's central

* The author wishes to thank Professor Christoph Engel, distinguished colleague, outstanding scholar, wonderful coauthor, German food connoisseur, and friend, for his insightful comments over the years, and looks forward to many more.

insight was that divorce law does not simply impose order from above. Instead, legal rules provide the framework within which divorcing couples bargain to determine post-dissolution rights and responsibilities. This stood in contrast to the prevailing view of the time that the family court's primary function was to protect the interests of third parties, particularly children, or to protect weaker spouses. Mnookin and Kornhauser wrote at the dawn of the no-fault revolution in divorce.¹ Their article argued a very Coasian point: if transaction costs are low and parties are reasonably well informed, bargaining should achieve efficient outcomes in divorce. The law would matter primarily in determining the distribution (who has bargaining power), not efficiency or, by extension, durability.²

In some ways, Mnookin and Kornhauser's article is different and more forward-thinking than the conventional formulation of the Coase theorem prevalent when the article was written. The conventional version

1 As I discuss further below, much of Professor Engel's research bears directly on understanding the strengths and limitations of Mnookin and Kornhauser's approach. Perhaps unsurprisingly, Christoph has also contributed directly to our understanding of how legal change unfolds. Writing with Keren Weinshall, he shows that innovations in law typically diffuse along an S-shaped path: a long period of stability, a phase of rapid adoption once reform takes off, and finally a plateau as the innovation becomes institutionalized (Engel and Weinshall, 2022). This pattern closely matches the trajectory of divorce law: decades of doctrinal stability, a wave of rapid change in the 1970s, as many jurisdictions around the world adopted no-fault divorce, and the eventual emergence of a new equilibrium of private ordering modeled by Mnookin and Kornhauser (1978).

2 An instructive example of what Medema (2020) describes as a "Coasian critique" is Donohue III (1990). Posner and Shavell had argued that shifting from the American rule (each party bears its own fees) to the British rule (loser pays) would affect settlement rates, since the parties' incentives to settle differ under the two regimes. Donohue responds by invoking the Coase theorem in its conventional "invariance" form. If transaction costs are low, litigants should be able to contract around the default fee-shifting rule, so efficiency and settlement rates should not depend on whether the law adopts the American or British rule. Donohue emphasizes that Posner and Shavell's prediction arises from overlooking this Coasean benchmark. Yet he also notes the puzzle: in practice, parties rarely contract around fee-shifting defaults, which suggests that either transaction costs are higher than theorists assume, or litigants fail to perceive and exploit the possibility of contractual adjustment. This highlights the broader function of a Coasian critique: to challenge theories that attribute substantive effects to legal rules by asking why private bargaining does not undo those effects. In the same spirit, my argument is that the divergent expectations model of divorce bargaining takes for granted that parties negotiate "in the shadow of the law," but fails to explain why divorcing spouses so often cannot or do not bargain their way around default rules to reach efficient and durable settlements.

was a proposition concerning externalities, which argued that if transaction costs are zero and property rights are well defined, bargaining between affected parties will lead to a Pareto-efficient allocation of resources regardless of the initial assignment of rights. Two claims follow: an efficiency proposition (bargaining leads to Pareto efficiency) and an invariance proposition (the efficient outcome does not depend on the initial legal entitlement).³

Almost 50 years after the publication of Mnookin and Kornhauser, it's worth asking their central question again. Why do the outcomes in divorce cases diverge from the irrelevance proposition of the Coase theorem? Consider the evidence discussed below: as was true 50 years ago, a large share of divorcing parties arrive in court with some matters already settled, and stipulated judgments remain the most common outcome in most courts. Table 1 shows that for divorce (dissolution) cases filed in Los Angeles Superior Court (LASC) between 2017 and 2024, the trial rate is only about 15 %, 40 % are stipulated judgments (settlements), while in 38 % one party does not participate (defaults).⁴ Mnookin and Kornhauser were interested in how legal rules and procedures influence this process of private ordering: to what extent do courts authorize and enforce privately negotiated commitments at divorce, and to what extent do legal or institutional limits constrain such commitments? Already in 1979, they emphasized that some areas of family law remained outside Coasian bargaining, such as community property rules, the “best interests of the child” standard, and statutory child support formulas. Since then, the trend has been toward greater acceptance of stipulated judgments with minimal judicial review, consistent with the limited investigatory capacity of courts.

3 In fact, in his original essay, Coase emphasized the opposite: in the real world, transaction costs are significant, and therefore legal rules matter for efficiency. As Medema and others point out, the “Coase theorem” as a formal proposition was really Stigler’s creation, distilled from Coase’s examples. Coase’s original aim was to highlight the centrality of transaction costs rather than to assert a clean theorem. Medema describes the Coase theorem as a “blackboard result,” a baseline for thinking about real-world institutions. The neat predictions of efficiency and invariance under zero transaction costs serve as a counterfactual against which we can evaluate the impact of legal rules, bargaining frictions, and institutional design.

4 Because California requires separate filing fees for a divorce petition and a response, some “defaults” may reflect settlements in which only one party pays the filing fee. In such cases, sometimes called a “default with agreement,” the respondent risks losing procedural protections, since failing to respond means the petitioner may still seek a different division of assets or custody than the parties agreed to informally.

For example, judges in the Los Angeles Superior Court routinely accept stipulated arrangements unless there is clear evidence that a child's safety is at risk. In practice, the court's function has become to process disputes and enforce settlements rather than to engage in independent fact-finding. So far, so good for the Mnookin and Kornhauser model.

However, the durability of these settlements is far less clear. As shown in Table 1 and Figure 2, evidence from the LASC shows that agreements often break down, particularly with respect to custody, visitation, and support. Unlike torts or contracts, family cases do not truly end at judgment. Even after settlement, either party may petition for modification on the grounds that circumstances have changed or that the best interests of the child require it. Mediation is common and often produces stipulated judgments, but these agreements appear to be fragile as modification requests consume a large share of judicial resources. This pattern is puzzling from a Coasian perspective. If transaction costs are low and parties could bargain efficiently at divorce, as would appear to be the case, they should be able to draft contingent contracts covering foreseeable contingencies, and there should be little need for repeated modification requests. The persistence of post-divorce requests for modification of previous judgments, even stipulated judgments (i.e., settlements), suggests that the Coase theorem's predictions do not map cleanly onto family law.

One way to motivate the puzzle is by comparison to civil litigation at LASC. In civil cases, fewer than 10 percent go to trial, and only about 2 percent are appealed. By contrast, although only 15 percent go to trial in divorce, roughly 8 percent of cases return to court for a request for modification within five years. Measured against the civil appeal rate, this persistence is striking: divorce judgments are four times more likely to be revisited than civil judgments, and unlike appeals, modification proceedings are not limited to error correction but reflect fresh bargaining failures. If we applied the Coase theorem in its most stringent form, we would expect post-divorce bargaining to reduce the need for judicial intervention to levels closer to the civil benchmark, not this elevated rate.

In principle, divorcing spouses could bargain over custody, visitation, alimony, or asset division once a marriage dissolves. The Coase theorem suggests that if transaction costs are low, the initial legal rule, such as the presumptive custody arrangement or the default property division, should not affect efficiency or durability. Parents could, in theory, trade or adjust rights to reach efficient arrangements, which theoretically should be durable since they were privately arrived at. The law would matter pri-

marily for distribution (i.e., which spouse has bargaining power), but not for efficiency.

Yet if divorce bargaining regularly defies these predictions, then we should consider the features of family disputes that make the Coase theorem's invariance proposition seem questionable. In one sense, all of this fits in the original spirit of Coase's article, if not the invariance proposition Stigler attributed to Coase. Transaction costs are high: lawyers' fees and asymmetric information about assets or parenting ability make bargaining costly. Commitment problems are endemic, particularly in custody disputes where cooperation must persist over years. Asymmetric information is pervasive: spouses may hide income, exaggerate needs, or misrepresent parenting quality. Children introduce third-party externalities, since their welfare is central, but they are not parties to the bargain. Finally, legal constraints limit bargaining freedom: custody must conform to the "best interests of the child," and child support is non-waivable by statute in most jurisdictions. However, some critiques go beyond Coase's original "transaction costs matter" limitation on the invariance theorem he may never have actually articulated. Mnookin and Kornhauser applied bargaining theory to divorce, arguing that default legal rules shape the bargaining set even when cases settle. But consider Farrell (1987)'s early critique of Coase, which contends that efficiency does not automatically follow from private negotiation, even absent transaction costs. This paper considers several possible problems with the strong Coasian invariance proposition as it applies to divorce and suggests several modifications to the standard divergent expectations model that might capture these limitations in ways that suggest possible avenues for future research.

This puzzle resonates with the research program of Christoph Engel, much of whose scholarship has been devoted to uncovering the limits of Coasian optimism and rational choice models, and to demonstrating the importance of institutions in remedying these limits. His contributions on bounded rationality and heuristics, the fragility of cooperation in social dilemmas, the role of institutional design in shaping behavior, and the externalities of collective goods all highlight mechanisms that derail efficient private ordering. In this spirit, the present essay revisits *Bargaining in the Shadow of the Law* and asks: why might divorce bargaining fail? Some potential answers are, of course, found in Engel's experimental work on the precariousness of cooperation (Engel and Rockenbach, 2024) and bounded cognition in property settings (Engel and Bar-Gill, 2024), in which he shows how limited rationality and behavioral biases systemat-

ically deter efficient trades once bargaining shifts from competitive markets into bilateral monopolies. For example, Mnookin and Kornhauser's original model relied on a market analogy, but several of Engel's experiments are suggestive that divorce bargaining may live in what Engel and Helland call the "fundamental transformation" zone, where Coasian optimism breaks down due to bilateral monopolies and information problems (Engel and Helland, 2023).⁵

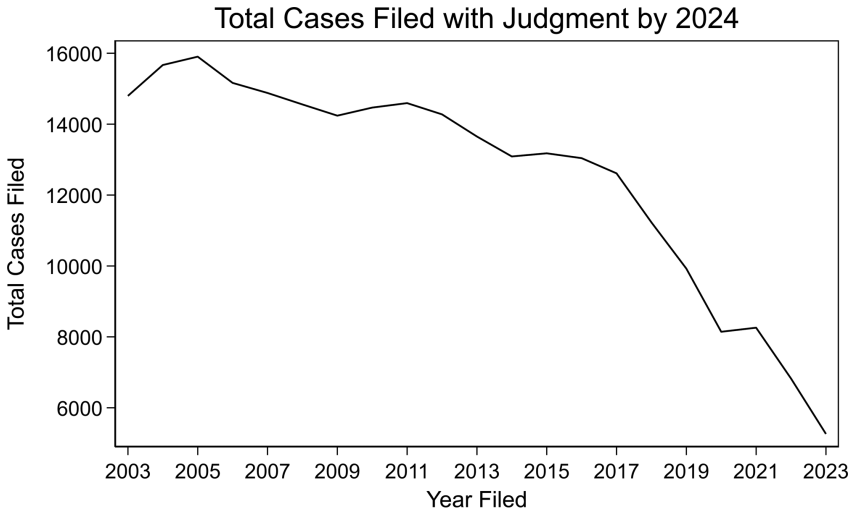
B. Evidence from the Los Angeles Superior Court

To motivate the puzzle at the heart of this paper, I begin with some statistics from the Los Angeles Superior Court (LASC). LASC is the largest unified trial court in the United States, handling more cases than any other single jurisdiction. Given the size of Los Angeles County, it is unsurprising that the court processes tens of thousands of divorce petitions each year. As shown in Figure 1, the number of divorces involving minor children has declined from a peak in 2003. In recent years, part of the apparent decline may reflect delays in case resolution, since my sample includes only completed cases. Nevertheless, the broader pattern is consistent with state and national trends: both in Los Angeles and California as a whole, the divorce rate has fallen since 2000, with roughly 8.9% of the adult population reporting that they are divorced.⁶

More interesting for this paper is the outcome and durability of divorce cases. As noted above, there is no apparent reason, in a pure Coasian invariance sense, that the outcomes in family court should be less likely to settle or that the resolutions that occur should be less durable than other civil cases. Nothing in the legal rules should prevent parties from, on average, forecasting future conditions and writing a full contingent,

5 Over Engel's career, he has paid particular attention to the role of judges, whether in defining collective goods, satisficing under cognitive limits (Engel and Güth, 2018), or balancing normative concerns (Engel and Rahal, 2019). Although not addressed in this essay, his work reminds us that the judge is not merely a cipher but an active institutional actor shaping bargaining outcomes. Although not directly addressed in the divergent expectations model, the role of judges in divorce cases is certainly important to understanding parties' behavior.

6 ⁶See U.S. Census Bureau, American Community Survey, 2018–2022 5-Year Estimates. The ACS measures the marital status of the population age 15 and older; the proportion currently divorced in California is approximately 8.9%.



Note: This graph shows data from LASC on dissolution petitions involving minor children.

Figure 1: Number of Divorce Petitions LASC

and hence durable, contract regardless of legal rules. As noted in the introduction, civil litigation at LASC is by some measures less contentious: fewer than 10 percent of cases go to trial, and only about 2 percent are appealed—typically larger high-stakes cases in the complex courts.

Outcomes in divorce cases in LASC fall into three broad categories: contested trials, stipulated judgments (settlements), and defaults (where one party does not appear). Not all litigants are represented by counsel, and judgments are frequently modified even when settlements are reached as custody, visitation, child support, and spousal support are repeatedly relitigated. Mediation is common and often produces stipulated judgments, but these agreements are not necessarily durable.

For context, consider the breakdown of outcomes for petitions filed between 2017 and 2024 presented in Table 1. In divorce cases with minor children, which judges suggest are the most contentious, 15 percent go to trial (a contested judgment), and roughly 8 percent of cases return to court for a request for modification within five years. Measured against the civil appeal rate, this lack of durability is interesting: divorce judgments are four times more likely to be revisited than civil judgments. Unlike appeals, modification proceedings are not limited to error correction but often reflect fresh bargaining failures.

Table 1: Requests for Modification by Judgment Type Dissolution Cases Involving Minor Children (2017–2024)

Outcome	Request for Modification in 2 years	Request for Modification in 5 years	Total Cases
Default Judgment	1,216	1,713	24,674
Stipulated Judgment	1,614	2,343	26,481
Contested Judgment	700	897	4,213
Other	164	222	9,545
Total	3,694	5,175	64,913

Unlike most civil cases, family cases rarely end with finality: appeals are infrequent, but either party can return to court to argue that circumstances have changed and seek modification of orders. Attorney involvement often generates substantial fees, further raising transaction costs. Consider Figure 2. The top panel shows the fraction of judgments requesting a modification within the next two years, while the bottom panel shows the fraction of judgments with modification requests within five years. Interestingly, while the proportion of those judgments seeking a modification grows, the increase is not dramatic, suggesting that modifications may not be driven entirely by changing circumstances.

From a Coasian invariance perspective, this pattern is puzzling. If transaction costs were low, parties should bargain efficiently over custody, support, and property division. Once an agreement is reached, especially in a stipulated judgment, parties should have internalized foreseeable contingencies, reducing the need for court intervention. Coasian invariance suggests that once a bargain is struck, the efficient frontier has been reached, and further modification petitions should be unnecessary.

What we observe in LASC seems at odds with the strongest predictions of a Coasian invariance proposition. A high proportion of custody and support orders are later modified, and often relatively quickly, whether initially stipulated by the parties or imposed by a judge. This raises a series of questions: Why do divorcing spouses not write contingent contracts anticipating future changes? Why do they return to court rather than adjust privately? Why are settlements not substantially more durable than judgments?

In the next section, we explore several explanations, including the high transaction costs of renegotiation, the difficulty of enforcing long-

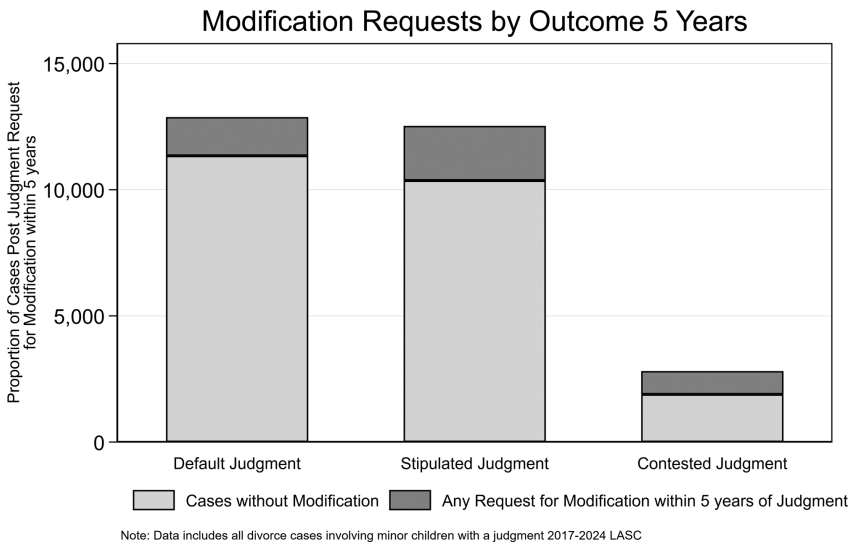
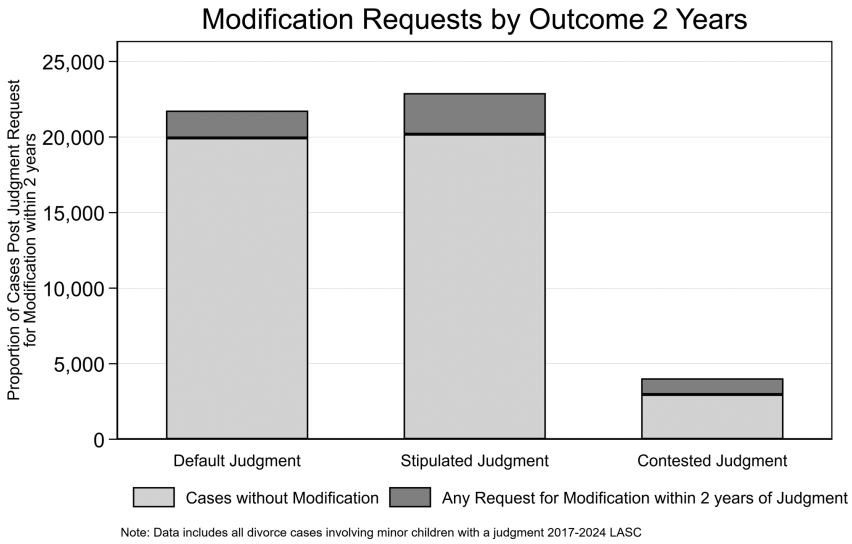


Figure 2: Requests for Modification

term commitments in parenting arrangements, pervasive private information, externalities to children, and legal limits on private ordering. Altruism and its strategic variants may also distort bargaining, as parents seek to present themselves as cooperative or caring even at efficiency's expense. Family law's statutory limits, especially the mandatory modifiability of child support, further guarantee that settlement is never truly final.

C. The Divergent Expectations Model in Divorce

I. Standard Model

A central contribution of Mnookin and Kornhauser (1978) was to show how divorce negotiations take place not in a legal vacuum but in the shadow of default rules and judicial procedures. Even when cases settle, the law shapes bargaining outcomes by providing threat points, structuring private commitments, and constraining opportunism. Subsequent work by Cooter, Marks, and Mnookin extended this insight into a broader bargaining theory of contracts, highlighting how legal rules influence not only efficiency but also the durability of negotiated outcomes.⁷

As typically presented, the model does not entirely capture why divorce cases are often among the most contentious cases the courts face. All divorces require resolution of two to four distributional issues: division of property and debts, possible claims on future earnings (alimony), child support, and custody/visitation arrangements. While property division and alimony can often be modeled as transfers, custody and visitation are indivisible rights at the core of family bargaining. In California, child support is determined by a statutory formula based on income and custody

⁷ There is a related literature on the economics of the family that reinforces these themes. Household bargaining models of the 1980s and 1990s (e.g. Manser and Brown, McElroy and Horney, and Lundberg and Pollak) treated divorce as a credible threat that shaped intra-marital allocations. Spouses' fallback positions, determined by what they could expect in divorce, influenced resource division within marriage and at separation. Later "divorce-threat" and lifecycle models explicitly incorporated limited commitment and dynamic interaction, showing that divorce laws, custody presumptions, and support rules shift bargaining power and can destabilize agreements. Empirical work confirms that legal reforms altering threat points, such as changes in child benefit allocation or custody presumptions, have measurable effects on intra-household outcomes and settlement behavior.

shares, but the remaining issues are subject to negotiation and judicial discretion. Litigants routinely report that outcomes are uncertain and highly fact-dependent, especially for custody and visitation. This background of uncertainty, combined with commitment problems and asymmetries of information, creates room for strategic bargaining and repeated requests for modification. To capture this dynamic, I adapt Cooter et al. (1982)'s "differing perceptions" model of litigation to the custody context. Instead of binary trial outcomes (plaintiff wins/loses), custody litigation may result in sole custody for one parent or joint custody, with associated asset allocations. Settlement occurs if there exists a transfer T that makes both parties weakly better off than their subjective trial values.

Let the total divisible assets be J . If custody outcome $c \in \{W, H, J\}$ occurs (wife custody, husband custody, joint custody), the husband receives $\alpha_c J$ and the wife $(1 - \alpha_c)J$. In addition, each parent values custody directly. Let

$$\begin{aligned} u_w(W) &= V + (1 - \alpha_W)J, & u_h(W) &= \alpha_W J, \\ u_w(H) &= (1 - \alpha_H)J, & u_h(H) &= V + \alpha_H J, \\ u_w(J) &= v + (1 - \alpha_J)J, & u_h(J) &= v + \alpha_J J, \end{aligned}$$

where $V > v \geq 0$ measures the utility of sole versus joint custody.⁸

Each party $i \in \{w, h\}$ incurs litigation cost C_i . Each has subjective beliefs about trial outcome probabilities:

$$\hat{p}_W^i, \hat{p}_H^i, \hat{p}_J^i, \quad \hat{p}_W^i + \hat{p}_H^i + \hat{p}_J^i = 1.$$

The wife's and husband's expected utilities from a trial are:

$$\begin{aligned} E_w^T &= \hat{p}_W^w u_w(W) + \hat{p}_H^w u_w(H) + \hat{p}_J^w u_w(J) - C_w, \\ E_h^T &= \hat{p}_W^h u_h(W) + \hat{p}_H^h u_h(H) + \hat{p}_J^h u_h(J) - C_h. \end{aligned}$$

Suppose the parties settle on a custody arrangement c and a net transfer T (from husband to wife). Then

$$U_w^S(c, T) = u_w(c) + T, \quad U_h^S(c, T) = u_h(c) - T.$$

8 Here, custody is modeled not as part of the divisible asset pool J , but as an indivisible entitlement that directly contributes to each parent's utility. The parameters V and v capture the nonpecuniary value of sole versus joint custody, reflecting that parenting rights cannot be reduced to purely monetary transfers.

The wife accepts (c, T) iff $T \geq T_{\min}^W(c) \equiv E_w^T - u_w(c)$; the husband accepts iff $T \leq T_{\max}^H(c) \equiv u_h(c) - E_h^T$.

Hence, settlement under custody outcome c is feasible iff

$$T_{\min}^W(c) \leq T \leq T_{\max}^H(c),$$

or equivalently,

$$E_w^T + E_h^T \leq u_w(c) + u_h(c). \tag{8}$$

If joint custody is excluded, only $c \in \{W, H\}$ remain. Assume symmetric valuations and asset splits so that the only stake is the custody value V . Let $\pi \equiv \hat{p}_W^w$ (be the wife’s belief she will win custody) and $q \equiv \hat{p}_W^h$ (the husband’s belief that his ex-wife wins). Then (8) reduces to

$$(\pi - q)V \leq C_w + C_h. \tag{9}$$

Settlement exists when (9) holds; trial occurs when it is violated.⁹

With $c \in \{W, H, J\}$, the condition (8) applies to each custody type. Define relative “stake differences” for custody k relative to c :

$$\Delta_w(k|c) = u_w(k) - u_w(c), \quad \Delta_h(k|c) = u_h(k) - u_h(c).$$

Then the feasibility under custody c is equivalent to

$$\sum_{k \in \{W, H, J\}} (\hat{p}_k^w \Delta_w(k|c) + \hat{p}_k^h \Delta_h(k|c)) \leq C_w + C_h.$$

A settlement exists if at least one custody choice c satisfies this inequality. The trial condition is the negation:

$$E_w^T + E_h^T > \max_{c \in \{W, H, J\}} \{u_w(c) + u_h(c)\}.$$

9 This is the custody analogue of the standard model’s $(P_p - P_d)J \leq C_p + C_d$.

Table 2: Symbols and Definitions for the Custody Adaptation of the Differing Perceptions Model

Symbol	Definition
J	Total divisible assets
α_c	Husband's share under custody outcome c
$u_i(c)$	Utility of party i under custody c (assets + custody value)
V, v	Nonpecuniary values of sole vs. joint custody
C_i	Litigation cost for party i
\hat{p}_c^i	Party i 's subjective belief about outcome c
E_i^T	Party i 's subjective expected trial utility
T	Transfer from husband to wife
$T_{\min}^W(c)$	Minimum transfer for wife to accept custody c
$T_{\max}^H(c)$	Maximum transfer for husband to accept custody c
Feasibility	$E_w^T + E_h^T \leq u_w(c) + u_h(c)$
Trial condition	$E_w^T + E_h^T > \max_c \{u_w(c) + u_h(c)\}$

Intuitively, settlement is possible whenever the parties' subjective trial values are not too far apart. Each side compares what it expects to receive at trial (net of costs) with what it could obtain through a negotiated custody arrangement plus a transfer. If the sum of their subjective trial values does not exceed the total surplus available under some custody outcome, then there exists an overlap, an interval of transfers $[T_{\min}^W(c), T_{\max}^H(c)]$, that both parties prefer to trial. This overlap is the settlement range. Conversely, if subjective trial values are so optimistic that they exceed any custody surplus together, no such overlap exists, and the case proceeds to trial. So far, the model is broadly consistent with Mnookin and Kornhauser (1978) and Cooter et al. (1982)'s prediction that the settlement rate should be relatively high, which we find in the LASC data. At the same time, custody differs from purely monetary disputes in one crucial respect: the subjective value of custody outcomes evolves as children age and circumstances change. This makes initial settlements more vulnerable to later contestation, helping to explain why requests for modification persist long after judgment in family law, in contrast to most other civil cases. In the following subsection, we modify the model to examine requests for modification after judgment.

In Table 2 we provide the definitions for each of the components of the modified model.

II. Requests for Modification

One issue not covered in the standard divergent expectations model is the possibility of a “request for modification,” in which one or both of the parties ask the court to modify the judgment after it has been agreed to in a settlement (stipulated judgment) or trial (contested judgment). To extend the model, I divide it into two stages.

Stage 1: pre-filing bargaining over custody $c \in \{W, H, J\}$ and transfer T ; if no agreement, trial 1 occurs.

Stage 2: either party may petition the court for reconsideration (a second adjudication). Before trial 2 (technically, a hearing on the request for modification), the parties may bargain again.

Let $u_i(c)$, beliefs \hat{p}_k^i , and costs C_i be as defined above. Stage-1 settlement under custody c is feasible iff

$$E_w^{T,1} + E_h^{T,1} \leq u_w(c) + u_h(c), \tag{10}$$

where

$$E_w^{T,1} = \sum_{k \in \{W,H,J\}} \hat{p}_k^w u_w(k) - C_w, \quad E_h^{T,1} = \sum_k \hat{p}_k^h u_h(k) - C_h.$$

After trial 1, suppose parties receive a signal s (e.g., the observed decision, judge’s reasoning, new evidence) that updates beliefs to $\hat{p}_k^{i,2} = \Pr(k | s)$ and induces incremental litigation costs $K_i \geq 0$ for a second trial.¹⁰ The Stage-2 expected trial utilities are

$$E_w^{T,2} = \sum_k \hat{p}_k^{w,2} u_w(k) - (C_w + K_w), \quad E_h^{T,2} = \sum_k \hat{p}_k^{h,2} u_h(k) - (C_h + K_h).$$

A Stage-2 settlement under custody c is feasible iff

$$E_w^{T,2} + E_h^{T,2} \leq u_w(c) + u_h(c). \tag{11}$$

Proposition 1 (Replication without changes). If $\hat{p}_k^{i,2} = \hat{p}_k^i$ for all i, k and $K_i = 0$, then the Stage-2 feasibility set (11) coincides with Stage 1 (10).

10 If no new information or cost change occurs, take $\hat{p}_k^{i,2} = \hat{p}_k^i$ and $K_i = 0$.

Hence, absent new information or cost changes, the second-stage bargaining problem is unchanged, and no new request for modification should arise. Broadly, Proposition 1 implies that when legal rules are transparent and circumstances remain stable, the Stage 2 problem simply reproduces Stage 1. In such environments, requests for modification should be rare, since the equilibrium is already renegotiation-proof.

Proposition 2 (Why post-trial settlement can emerge). Suppose at least one of the following holds: (i) belief dispersion shrinks after s (e.g., $\hat{p}^{w,2}$ and $\hat{p}^{h,2}$ move closer); (ii) incremental costs $K_w + K_h > 0$; (iii) the court's first decision $y \in \{W, H, J\}$ changes the custody/asset baseline relevant to $u_i(c)$ (e.g., status quo bias or enforcement frictions). If the first judgment y shifts the effective baseline, then the surplus term $u_w(c) + u_h(c)$ is evaluated relative to y , which can raise the RHS of the Δ -form inequality and create overlap at Stage 2.¹¹ Then (11) can hold even when (10) failed, creating a Stage-2 settlement interval

$$[T_{\min}^{W,2}(c), T_{\max}^{H,2}(c)] = [E_w^{T,2} - u_w(c), u_h(c) - E_h^{T,2}].$$

Equivalently, in the $\{W, H, J\}$ model, any combination of (i) smaller $\sum_k |\hat{p}_k^{w,2} - \hat{p}_k^{h,2}|$, (ii) larger $K_w + K_h$, or (iii) a baseline shift from y that increases $\max_c \{u_w(c) + u_h(c)\}$ can turn infeasibility at Stage 1 into feasibility at Stage 2.

Lemma (Stage-2 feasibility without Stage-1 feasibility). If $(\pi^{(1)} - q^{(1)})V > C_w + C_h$ but $(\pi^{(2)} - q^{(2)})V \leq C_w + C_h + K_w + K_h$, then no settlement overlap exists at Stage 1 while a (nonempty) settlement interval exists at Stage 2.¹²

Intuitively, updated beliefs, additional expected costs, or a changed outside option expand the overlap of reservation values and make settle-

11 Put more intuitively: once the court enters a custody order as part of the judgment, it essentially becomes the default arrangement—hence the terminology “request for modification.” Parents now face legal requirements that make the existing order the starting point for future bargaining. A first judgment, therefore, shifts the baseline so that even if the original settlement range was empty, a new overlap of interests may appear when the order itself anchors the parties’ expectations.

12 Formally, if only $\{W, H\}$ are available and the stake is V , the Stage-2 analogue is $(\pi^{(2)} - q^{(2)})V \leq C_w + C_h + K_w + K_h$, where $\pi^{(2)} = \hat{p}_W^{w,2}$ and $q^{(2)} = \hat{p}_W^{h,2}$. Settlement post-trial becomes strictly more likely when $K_w + K_h > 0$ or when $|\pi^{(2)} - q^{(2)}|$ shrinks.

ment more likely. Put differently, if the judge does something the parties did not expect, the request for modification can be a way to get a judgment closer to the parties' expectations.

In custody bargaining, the judge's prospective assignment (and its uncertainty) forms the outside option that shapes negotiated outcomes; adding a reconsideration stage simply re-runs the same overlap test with updated beliefs and costs. Without such updates, there is no reason to expect a different negotiated arrangement before a second trial. With updates (new information from the first proceeding, altered risk, or added costs), a second-stage settlement can arise even when the first stage failed.¹³

What role does anticipation play, and when is a judgment in this model renegotiation-proof? Suppose parties foresee a reconsideration stage (Stage 2) after an initial adjudication. If there is no new information and no cost change (beliefs $\hat{p}_k^{i,2} = \hat{p}_k^i$ and incremental costs $K_i = 0$), then the Stage 2 overlap test

$$E_w^{T,2} + E_h^{T,2} \leq u_w(c) + u_h(c)$$

coincides with the Stage 1 test. Hence, the Stage 1 bargaining problem already internalizes the possibility of reconsideration, and any Stage 1 equilibrium that is subgame-perfect is renegotiation-proof: off-path petitions for reconsideration should not be observed. By contrast, if Stage 2 brings either (i) belief convergence (updated $\hat{p}_k^{i,2}$ after observing the first proceeding) or (ii) added second-trial costs $K_w + K_h > 0$, then

$$E_w^{T,2} + E_h^{T,2} = \sum_k \hat{p}_k^{w,2} u_w(k) + \sum_k \hat{p}_k^{h,2} u_h(k) - (C_w + C_h + K_w + K_h)$$

can fall relative to Stage 1, so the overlap condition may newly hold even if it previously failed. In short, absent updates, the reconsideration game replicates Stage 1; with updates, a post-trial settlement interval $[T_{\min}^{W,2}(c), T_{\max}^{H,2}(c)] = [E_w^{T,2} - u_w(c), u_h(c) - E_h^{T,2}]$ can open where none existed ex ante.

Broadly, the lesson of extending the divergent expectations model is that requests for modification arise only when the underlying belief

13 For example, the high turnover in family courts, where judges typically last only a few years before being transferred to areas such as criminal law or general civil, inadvertently leads to more requests for modification because it results in new information to the parties.

structure or the cost environment changes, thereby reopening a settlement range. Since large shifts in litigation costs or judicial consistency are relatively rare, these mechanisms alone cannot explain the frequency of modification requests observed in the LASC data. In the next section, we turn to several alternative explanations for why modifications persist despite the availability of private ordering.

D. Possible Explanations for the Modification Puzzle

Taking the divergent expectations model as their starting point, Mnookin and Kornhauser (1978) asked a simple question: if negotiated settlements are private ordering, why would divorcing spouses ever proceed to trial, and why, we could add in the spirit of their model, would they ever seek to modify an existing settlement or judgment? The obvious answer captured by their model is that circumstances change. However, if bargaining is efficient, parties should be able to contract around foreseeable contingencies and reach durable agreements. Yet, in practice, custody, visitation, and support orders are frequently reopened and often for reasons that would appear entirely foreseeable. This suggests a broader set of frictions on the efficiency of private ordering.

In fact, Mnookin and Kornhauser (1978) identified several reasons why bargaining may fail: spite between the parties, a general dislike of negotiation that raises transaction costs, fundamental disagreement over the likely trial outcome, or the absence of a meaningful middle ground when the resources at issue are too small relative to the value each parent places on custody. In many ways, these insights suggest several pathways to modifying their model in ways that would explain why some cases are litigated rather than settled.

Over the last 50 years, captured in much of Professor Engels' work, our understanding of how people behave in bargaining negotiations has provided several other explanations for the puzzle of why so many divorce cases are contested and further why so many cases that are settled or adjudicated return to court for modification. The possible explanations explored in this article include: private information and misrepresentation, which distorts bargaining outcomes; negative altruism, which can undermine hard bargaining while still producing inefficiency; externalities to children, whose evolving needs are not internalized by parents; transaction costs of renegotiation and court enforcement; commitment

problems that make long-term promises in custody or visitation unstable; legal limits that forbid parties from contracting around certain obligations such as child support; and finally, agency problems stemming from the incentives of lawyers in the family law system. Each of these explanations offers a different perspective on why settlements in divorce are often fragile and why requests for modification are so common. In what follows, I consider each in turn.

I. Bargaining Theory Limits

In its strong form, the Coase theorem predicts that if transaction costs are absent and property rights are clearly defined, parties will bargain their way to efficient outcomes regardless of the initial assignment of rights. This “market-like” intuition underlies much of the early law-and-economics work on divorce: spouses should be able to exchange entitlements to custody, visitation, or support until the allocation maximizes joint welfare, and judgments or settlements should be durable because parties cannot do any better – an extension of the first welfare theorem. In this view, the law matters primarily for distribution, not efficiency. Yet the more recent literature on bargaining theory has suggested problems with this market analogy. For example, in perhaps the most famous critique of the Coasian invariance proposition, Farrell (1987) stresses that bargaining is typically conducted under conditions of incomplete information. In contrast, the Coasian invariance theorem, in its strong form, predicts that if transaction costs are absent and property rights are clearly defined, parties will have enough information to bargain their way to efficient outcomes regardless of the initial assignment of rights. This minimization of information’s impact produces the “market-like” intuition that underlies much of the early law-and-economics work on divorce and its predication that spouses should be able to exchange entitlements to custody, visitation, or support until the allocation maximizes joint welfare. In this view, the law matters primarily for distribution, not efficiency, because information problems can be overcome.

Farrell doubts this market analogy, stressing that bargaining is typically conducted under conditions of incomplete information. Divorcing spouses often have private information about income, assets, future plans, or even their capacity to comply with parenting schedules. When parties strategically misrepresent that information, bargaining becomes

distorted. Screening and signaling strategies lead to delay, costly litigation postures, or inefficient agreements that later unravel. The implication is that even if Coasian “transaction costs,” defined as the cost of enforcing property rights, are minimal, informational frictions prevent bargaining from reliably delivering efficient outcomes.

Binmore et al. (1998) presents a slightly different critique. He argues that bargaining is not a market at all. In markets, competitive forces push resources toward efficient allocations; in bilateral bargaining, outcomes depend heavily on timing, threats, focal points, and institutional context. Bargaining games often have multiple equilibria, and efficiency is not guaranteed. In divorce, this means that legal rules, custody presumptions, support formulas, and domestic violence protections do more than shift bargaining power. They structure the game itself, determining the available strategies and which equilibria are plausible.

More broadly, these critiques suggest that the Coasian optimism embedded in Mnookin and Kornhauser’s “shadow of the law” model may be overstated. Divorce bargaining is a bilateral monopoly, not a competitive market. Private information, strategic misrepresentation, and the institutional levers supplied by family law make breakdowns and inefficient outcomes common. If efficiency is not the natural prediction of bargaining theory, then it is unsurprising that divorce settlements so often give rise to post-judgment modification requests.¹⁴

Formally, in the divergent expectations model, these critiques would involve allowing bargaining to fail not because of differing beliefs alone but because of strategic risk and delay. Let $\theta \in (0, 1)$ denote the probability that bargaining breaks down and proceeds directly to trial, and let $\delta_i \in (0, 1]$ be party i ’s discount factor for delay.

If the custody outcome c is agreed with the transfer T , the expected discounted utility is

$$U_w^S(c, T) = (1 - \theta) \delta_w [u_w(c) + T] + \theta E_w^T,$$

$$U_h^S(c, T) = (1 - \theta) \delta_h [u_h(c) - T] + \theta E_h^T.$$

14 In principle, these informational frictions could also be framed as raising the cost of bargaining, since concealment and misrepresentation often require discovery or enforcement proceedings to resolve. For clarity, in this section, we treat them primarily as distortions to subjective beliefs and return to their transaction-cost dimension below.

Settlement under custody c is feasible iff

$$(1 - \theta)(\delta_w + \delta_h) [u_w(c) + u_h(c)] + \theta (E_w^T + E_h^T) \geq E_w^T + E_h^T. \quad (12)$$

Compared to the baseline overlap condition $E_w^T + E_h^T \leq u_w(c) + u_h(c)$, the presence of $\theta > 0$ and $\delta_i < 1$ reduces the effective surplus from settlement. Intuitively, breakdown risk and delay shrink the settlement range, making trial more likely. A reconsideration stage may improve prospects only if the first trial reduces belief dispersion or increases perceived θ , thus shifting the inequality in favor of settlement at Stage 2.

Like much litigation, the LASC family law data reflects this dynamic in discovery disputes, repeated continuances, and evidentiary hearings, all of which suggest that private information and strategic misrepresentation routinely derail efficient settlement.

II. Interdependent Utilities and Spite

The two-stage model showed how updates to beliefs or costs can generate requests for modification. Yet that analysis preserved a central assumption of the Coase theorem: each party's utility depends only on their own consumption or payoffs. In this separable-utility world, inefficiencies arise only from informational frictions or enforcement costs. However, household bargaining models, beginning with Becker, long recognized that spouses' utilities are interdependent: one person's well-being directly enters the other's utility function. In the divorce context, those interdependencies can run in both directions, sometimes positively (altruism), but, in light of the fact that parties are divorcing, more often negatively (spite). Importantly, these interdependencies are not transaction costs but preferences: even if bargaining is costless, utilities that incorporate spite can block efficient trades and destabilize settlements.¹⁵

15 Recent work by Gilbert and Hayashi (2025)) shows how altruism fundamentally changes the predictions of the Coase theorem. Under the strong version of Coase's claim, two results follow if transaction costs are zero: (a) bargaining produces Pareto-efficient outcomes, and (b) the efficient outcome is invariant to the initial allocation of rights. Gilbert and Hayashi demonstrate that these predictions no longer hold once utilities include others' welfare. With pure altruism, where one party values the

If one party's utility decreases when the other does well, then bargaining need not converge on efficient or even mutually acceptable outcomes. Divorce disputes often feature elements of spite: parties may be willing to absorb personal costs in order to reduce the other's welfare. This kind of interdependent utility is outside the Coasian framework, yet it is exactly what we observe in practice, and it helps explain why settlements often fail or unravel.

Children complicate the picture further by serving as implicit third parties in the bargaining game. In theory, divorcing parents could negotiate custody and support. However, children are not at the table, even though their welfare is at stake. Parents may internalize some of their children's utility, but altruism toward children is uneven; one parent may weigh the child's needs more heavily than the other, or value the child's welfare only when it reflects back on their own custody or reputation. The result, as Gilbert and Hayashi show in their general analysis, is that efficiency and invariance break down when third-party welfare is only partially embedded in bargaining parties' utilities. Parents may trade away long-term child welfare for short-term gains in custody or support, leaving agreements fragile. The "best interests of the child" standard and the non-waivable character of child support can be seen as institutional correctives: they force the child's welfare into the bargain in a way that private negotiation alone cannot guarantee.

To formalize these intuitions, suppose each party experiences disutility from the other party's utility.¹⁶ Let $\lambda_w, \lambda_h \in [0, 1)$ measure the intensity of spite for the wife and husband, respectively. Under custody c and transfer T ,

other's outcomes regardless of cause, Pareto efficiency and invariance can survive in a limited sense, but allocative efficiency can fail, because altruistic parties may refuse payments or concessions that make them feel complicit in the other's harm. With impure altruism, "warm glow," where utility depends on having personally caused a benefit, both efficiency and invariance collapse: outcomes depend heavily on initial entitlements, and efficient bargains may be blocked altogether. Importantly, altruism is not a "transaction cost" but a preference. Even with zero transaction costs, altruistic or impurely altruistic utilities can prevent efficiency.

16 In the category of a movie quote being worth several thousand datapoints: "Please, Jess, Marie. Do me a favor, for your own good, put your name in your books right now before they get mixed up and you won't know whose is whose. 'Cause someday, believe it or not, you'll go fifteen rounds over who's gonna get this coffee table. This stupid wagon wheel Roy Rogers garage sale coffee table!" *When Harry Met Sally* (1989). However, for evidence with over 15,000 data points, see Chang et al. (2024).

Under custody c and transfer T ,

$$U_w^S(c, T) = u_w(c) + T - \lambda_w [u_h(c) - T],$$

$$U_h^S(c, T) = u_h(c) - T - \lambda_h [u_w(c) + T].$$

With subjective beliefs \hat{p}_k^i ,

$$E_w^T = \sum_k \hat{p}_k^w (u_w(k) - \lambda_w u_h(k)) - C_w, \quad E_h^T = \sum_k \hat{p}_k^h (u_h(k) - \lambda_h u_w(k)) - C_h.$$

A settlement under custody c is feasible iff

$$E_w^T + E_h^T \leq u_w(c) + u_h(c) - (\lambda_w u_h(c) + \lambda_h u_w(c)). \quad (13)$$

Relative to the baseline condition $E_w^T + E_h^T \leq u_w(c) + u_h(c)$, the effective surplus on the right-hand side is reduced by spite terms. Thus, spite shrinks the settlement range and makes trial more likely. At a reconsideration stage, unless spite parameters λ_i change, the overlap condition (13) is unaffected, so new settlements arise only if beliefs or costs change after trial.

In practice, the role of spite is visible in hostile filings, cross-motions, and requests that appear more punitive than instrumental and a refusal to settle when the outcome could, according to judges, be easily predicted, patterns common in the LASC docket and consistent with utilities that include negative interdependence.

III. Transaction Costs

Unlike spite or altruism, which alter preferences, transaction costs operate directly on the feasibility of settlement itself. Even if parties are willing to settle, the additional resources required to implement an agreement may tip the balance toward trial or later modification. In some ways, my approach differs from Mnookin and Kornhauser (1978), who argue that in their divorce model, bargaining is shaped by a broader definition of transaction costs, ranging from financial expense to emotional strain. By contrast, in this paper, I follow Gilbert and Hayashi (2025) and Medema

(2020) and adopt a narrower definition than is often found in the Coasian literature: transaction costs are the resources used to establish, defend, and enforce property rights. Under this framing, preferences such as spite or altruism belong to the parties' utility functions, as was done above, and are not the costs of transacting. Thus, transaction costs include the legal fees, enforcement expenses, discovery costs, and procedural hurdles that stand between divorcing spouses and a stable allocation of custody, support, or property.¹⁷

Even under this narrower definition, divorce is marked by unusually high transaction costs relative to other civil cases. The involvement of minor children amplifies the number of issues to be negotiated, and higher levels of income or property raise the stakes of bargaining. Emotional and psychological conflict further inflate transaction costs by prolonging mediation and increasing reliance on attorneys, even when utilities are otherwise independent. Enforcement poses another challenge: stipulations approved by the court are fragile because parents may renege on visitation, resist relocation, or fail to pay support. Since private enforcement is impossible, each breakdown requires renewed litigation, raising the effective cost of settlement.

Information problems compound these difficulties. Parties often conceal income, misrepresent assets, or exaggerate parenting ability. Establishing the truth requires discovery, expert testimony, and evidentiary hearings, all of which consume resources. In some sense, this is captured by Farrell's critique that bargaining with private information produces inefficiency even when direct negotiation appears low-cost. Children's welfare introduces another structural cost. Because children are not parties to the bargain, the court must represent their interests. As those interests evolve with age and circumstances, agreements that seemed workable at one point in time may quickly become obsolete, requiring further legal intervention.

Finally, legal rules themselves operate as sources of transaction costs. Although courts often rubber-stamp stipulated judgments, family law im-

17 Information problems compound these difficulties. Parties often conceal income, misrepresent assets, or exaggerate parenting ability. Establishing the truth requires discovery, expert testimony, and evidentiary hearings, all of which consume resources. Although in principle such informational frictions could be modeled as shifts in subjective beliefs (as in the previous section), in practice they also generate substantial enforcement and evidentiary costs, so here they can be treated as transaction costs in their own right.

poses mandatory mediation, statutory formulas for child support, and procedural requirements constraining bargaining. These measures reflect policy judgments about child protection and fairness, but they also act as frictions: they limit the bargaining set, delay resolution, and increase the resources required to reach a durable settlement. In short, even when parties are motivated to settle, the cost of defining, defending, and enforcing property and custody rights in divorce remains high, which may go a long way to explaining why settlements are more fragile in family law and, hence, why modification requests are so common.

To formalize this intuition in the divergent expectations model, imagine that in addition to trial costs C_i , each party incurs a transaction cost $S_i \geq 0$ when negotiating and implementing a settlement (e.g. mediation fees, drafting, enforcement filings). If custody c is agreed with transfer T , then

$$U_w^S(c, T) = u_w(c) + T - S_w, \quad U_h^S(c, T) = u_h(c) - T - S_h.$$

Trial payoffs remain as in the baseline model:

$$E_w^T = \sum_k \hat{p}_k^w u_w(k) - C_w, \quad E_h^T = \sum_k \hat{p}_k^h u_h(k) - C_h.$$

A settlement under custody c is feasible iff

$$E_w^T + E_h^T \leq u_w(c) + u_h(c) - (S_w + S_h). \quad (14)$$

This condition is the settlement analogue to the divergent expectations model's baseline inequality, adjusted for settlement costs. Relative to the original condition $E_w^T + E_h^T \leq u_w(c) + u_h(c)$, the effective surplus is reduced by the combined transaction costs $S_w + S_h$. This shrinks the settlement range and makes trial more likely at Stage 1. At a reconsideration stage, if the second trials involve additional incremental costs $K_w + K_h$ exceeding $S_w + S_h$, then (14) may newly hold, making post-trial settlement more attractive.

Empirically, transaction costs show up in enforcement hearings, legal and filing costs, and procedural delays in LASC, where even stipulated judgments frequently return to court because the cost of enforcing and sustaining them appears to be high.

IV. Commitment Problems

Unlike transaction costs, which reduce surplus through resource expenditures, commitment problems reduce surplus through anticipated non-compliance: parties discount the value of agreements because they expect them to unravel. The conventional Coasian framework assumes that once a bargain is struck, it can be costlessly enforced. Enforcement is taken for granted: in Coase's canonical examples, the farmer and railroad can write a contract, and if one side breaches, courts (or private mechanisms) perfectly ensure compliance. Under this assumption, commitment problems are irrelevant. Once agreement is reached, the bargain is stable, and the efficient allocation is realized.

Divorce bargaining looks very different. Agreements about custody schedules, child support, schooling choices, or relocations are ongoing, testing the limits of already frayed relationships. They are not one-off transfers. They are especially fragile because enforcement is weak. Child support is technically enforceable, but requires continuous monitoring and repeated motions to collect; arrears are common. Custody and visitation orders are even harder to police: courts and law enforcement are reluctant to intervene in day-to-day disputes over pick-ups, extracurricular activities, or holiday schedules, and doing so can be traumatic for children. Unlike contracts for goods or money, there is no private enforcement option – no “repo man” for visitation rights.

As a result, parents strike bargains in the shadow of anticipated defection. Each side knows an agreement may not stick, so they hold back, over-invest in litigation, or design rigid rules that quickly become inefficient. The instability of bargains generates recurrent inefficiency: parties anticipate breakdowns, return to court, or fail to reach agreement in the first place. This is why modification petitions are so common: they substitute for reliable enforcement mechanisms. *Ex ante*, parties distort their bargains by shading toward self-protection (e.g., requesting sole custody to reduce reliance on the other parent). *Ex post*, agreements often collapse, leading to renewed litigation.

To capture this dynamic, suppose settlements are imperfectly enforceable: with probability $\lambda \in [0, 1]$, a party reneges or the arrangement fails, reducing the realized surplus. Equivalently, let λ denote the expected “leakage rate” of settlement surplus. If custody c is agreed with the transfer T , then each party anticipates only a fraction $(1 - \lambda)$ of the promised

payoffs:

$$U_w^S(c, T) = (1 - \lambda) [u_w(c) + T], \quad U_h^S(c, T) = (1 - \lambda) [u_h(c) - T].$$

Trial payoffs remain as in the divergent expectations model:

$$E_w^T = \sum_k \hat{p}_k^w u_w(k) - C_w, \quad E_h^T = \sum_k \hat{p}_k^h u_h(k) - C_h.$$

Settlement under custody c is feasible iff

$$E_w^T + E_h^T \leq (1 - \lambda) [u_w(c) + u_h(c)]. \quad (15)$$

Relative to the baseline condition in the divergent expectations model, $E_w^T + E_h^T \leq u_w(c) + u_h(c)$, the enforceable surplus is now scaled down by $(1 - \lambda)$. This shrinks the settlement range and makes a trial relatively more attractive, since court-imposed orders may be easier to enforce. At a reconsideration stage, if the court's involvement lowers λ , then (15) may newly hold, opening the door to post-trial settlement or renegotiation. Empirically, high rates of child support arrears and recurrent custody modification petitions in LASC are consistent with a high λ : parties discount settlements heavily because they anticipate defection or weak enforcement, which helps explain the volume of post-judgment litigation.

V. Legal Limits (Non-Contractibility, Third-Party Rights)

Unlike transaction costs or commitment problems, which reduce the effective surplus from settlement, legal limits reshape the bargaining set itself by ruling out certain outcomes *ex ante*. In practice, not all custody arrangements or transfers are legally enforceable. Some outcomes are barred outright by statute or by the embedded rights of third parties, such as children. Family law deliberately restricts the bargaining domain by forbidding parents from contracting away certain obligations. For example, child support is, by statute, modifiable regardless of agreement, and custody stipulations are always subject to judicial review under the "best interests of the child" standard. These limits are not simply transaction costs or bargaining breakdowns; they are institutional veto points that constrain what private ordering can achieve.

The strong invariance version of Coase's theorem presumes a well-defined legal entitlement: the farmer has the right to clean air, or the rail-

road has the right to pollute. Once such a right exists, parties can bargain around it at zero transaction cost to reach an efficient allocation. But if the law refuses to recognize a right in the first place, whether because of moral concerns (as in organ sales) or deliberate vagueness (as in airplane seat recline), then there is no entitlement to trade, and hence no, or at least less, Coasian bargaining space. Divorce has these issues. Sometimes rights do not exist at all in alienable form, as when parents cannot agree to waive child support. Other times, rights exist but are held “in trust” for children, who cannot bargain for themselves. The bargaining set is narrower than Coase’s framework assumes in both cases.

These legal limits directly affect the durability of divorce settlements. Property division and spousal support, which are more contractible, tend to be relatively stable. Custody and child support, which are legally non-waivable, are inherently less durable because the law reserves the power to reopen or override agreements. The observed instability of settlements in family court is not just a function of transaction costs, information asymmetries, or commitment problems. It reflects that the law prohibits fully private ordering in domains where children’s welfare is at stake.

More broadly, family law highlights a feature Coase never addressed: the deliberate withholding of alienable rights when trades would harm third parties. In divorce, this is not a marginal issue but the central feature of custody and child support law. Parents may strike agreements, but those bargains are always provisional, subject to judicial oversight and the possibility of modification. Durability arises only when the law resolves the third-party problem directly, for example, by declaring one parent unfit or allowing a child of sufficient age to express their custodial preference. In all other cases, bargaining outcomes remain legally contingent, illustrating how legal rules not only shape distribution but also define the scope of bargaining itself.

Formally, let the feasible custody set be $\mathcal{C} \subseteq \{W, H, J\}$, and let each custody outcome $c \in \mathcal{C}$ allow only transfers in $[\underline{T}_c, \overline{T}_c] \subseteq \mathbb{R}$. A settlement (c, T) is feasible iff

$$T_{\min}^W(c) \leq T \leq T_{\max}^H(c), \quad \text{with } T \in [\underline{T}_c, \overline{T}_c], \quad c \in \mathcal{C}. \quad (16)$$

Equivalently, feasibility requires

$$E_w^T + E_h^T \leq u_w(c) + u_h(c),$$

and the existence of a transfer T in the legally permitted interval.

Legal limits reduce the feasible custody set and narrow the transfer interval relative to the baseline divergent expectations model. This shrinks the settlement range and makes trials more likely since the court may impose outcomes that parties cannot privately contract. At a reconsideration stage, if judicial authority expands the set of admissible outcomes (e.g. by authorizing joint custody when parties could not), condition 9) may newly hold and enable post-trial settlements.¹⁸

In LASC, this legal structure is reflected in the fact that custody and support orders are the categories most frequently subject to modification. In contrast, property and spousal support, having far fewer limits on the terms parties are allowed to negotiate, are far less likely to return to court.

VI. Agency Problems (Lawyer Incentives)

Another possible source of bargaining failure in divorce lies not in the parties' own preferences or transaction costs, but in the incentives of their legal representatives. In many areas of civil litigation, lawyer and client interests are closely aligned. As Spier (2007) observes, contingent fees in tort cases give both lawyer and client the same objective: maximize the expected settlement quickly, since delay or wasteful litigation reduces their joint surplus. By contrast, family law overwhelmingly relies on hourly billing or flat retainers. In divorce cases, by contrast, the absence of contingent fees means lawyers face no direct cost from delay and may even benefit from prolonged conflict. This fee structure creates a classic principal-agent problem. While divorcing spouses often want

18 These dynamics are more complex when legal protections themselves reshape bargaining incentives. Consider Engel and Bar-Gill, whose paper shows experimentally that the strength of legal remedies shapes willingness to trade entitlements in heterogeneous ways (Bar-Gill and Engel, 2018). They find that some participants become more willing to transact when rights are strongly protected ("positive types"), others are less willing ("negative types"), while some are unaffected. This heterogeneity implies that legal protection can either expand or collapse the settlement range depending on the parties' fairness norms. In terms of the taxonomy here, this is less a matter of spite than of commitment and legal limits: the way rights are defined and enforced influences the credibility of bargained-for transfers and whether the parties perceive settlement as fair or legitimate. In divorce, the strength of custody or property entitlements may similarly entrench one party. At the same time, stronger rights can make the other party more willing to compromise, which helps explain bargaining failure even when efficient trade is possible.

to resolve their disputes efficiently and durably, their lawyers may have financial incentives to prolong litigation, encourage discovery disputes, or craft settlements likely to produce future disputes that generate additional fees.¹⁹

Attorneys also shape bargaining outcomes in subtler ways. By controlling the flow of legal and factual information, they influence how clients perceive risks and how the “shadow of the law” is framed. Aggressive lawyers may downplay litigation risks to justify a trial, while risk-averse ones may exaggerate them to encourage a settlement. Retaining a high-priced or aggressive attorney can even serve as a costly signal of willingness to litigate, distorting bargaining in ways consistent with Farrell’s costly signaling problems. Moreover, inequalities in lawyer quality and the fact that many parties are self-represented further amplify asymmetries. A weaker party with no representation or an outmatched lawyer may agree to terms that are unstable or unfair, leading to later modification petitions.²⁰

Formally, in family court, lawyers may have objectives that diverge from their clients’ interests. Let $\gamma_i \geq 0$ denote the extra utility counsel derives from trial (e.g. billing, reputation) and $\sigma_i \geq 0$ denote the disutility from settlement (e.g. lower fees, less visibility).²¹

19 What is less clear is the importance of the repeat-play nature of family law, which magnifies these agency problems. Unlike tort cases, divorce need not end with the final judgment. Custody, visitation, and support arrangements frequently return to court for enforcement or modification. Lawyers, therefore, may anticipate recurring disputes and, consciously or not, could design fragile settlements, for failing to advise their clients about the fragile nature of the settlement the parties think they want, which ensures future involvement.

20 These incentive problems have inspired new experiments in legal practice, such as Hello Divorce, which operates on a flat-fee basis and combines document automation with attorney or mediator support. The goal is to reduce reliance on hourly billing and to realign lawyer incentives with client welfare by lowering costs, improving predictability, and facilitating cooperative resolution. Hello Divorce has been able to experiment with this model in Utah’s regulatory “sandbox,” which permits nonlawyer ownership and innovative delivery structures. See Stanford Law School, *Legal Innovation After Reform* (Sept. 29, 2022), <https://law.stanford.edu/2022/09/29/stanford-law-report-on-legal-innovation-after-reform>. However, in most states, such models remain constrained by unauthorized practice of law (UPL) rules and restrictions on nonlawyer ownership of law firms. These structural legal limits mean that the efficiencies promised by flat-fee, tech-enabled platforms cannot be fully realized outside of experimental jurisdictions like Utah.

21 Unlike the contingent fee arrangements often studied in civil litigation, family law and divorce attorneys are typically retained on a flat fee basis with an upfront retainer.

For a settlement (c, T) :

$$U_w^{S,agent}(c, T) = u_w(c) + T - \sigma_w, \quad U_h^{S,agent}(c, T) = u_h(c) - T - \sigma_h.$$

For trial:

$$E_w^{T,agent} = E_w^T + \gamma_w, \quad E_h^{T,agent} = E_h^T + \gamma_h.$$

A settlement under custody c is feasible iff

$$E_w^{T,agent} + E_h^{T,agent} \leq u_w(c) + u_h(c) - (\sigma_w + \sigma_h). \quad (17)$$

Relative to the baseline condition, lawyer incentives both inflate the perceived trial values (via $+\gamma_i$) and reduce the effective settlement surplus (via $-\sigma_i$). This shrinks the settlement range and makes trial more likely than under client preferences alone. At a reconsideration stage, if fee budgets are depleted or reputational motives change, the agency distortions may diminish, expanding the overlap and making post-trial settlement more likely.

Broadly, this aligns with what we observe at LASC: cases with higher attorney involvement are more likely to generate repeated motions and post-judgment hearings, consistent with either selection effects, lawyers are involved in more contentious cases, or lawyer incentives, that is, lawyers continuing the case when the outcome is not entirely predictable to increase fees. Several court personnel have suggested that one of the primary causes of a stipulated judgment request in a contentious divorce case is that the parties have exhausted their retainers and can no longer afford their lawyers.

VII. Model Summary

The six deviations from the Coasian benchmark each shrink the settlement range, but they do so through different mechanisms. Bargaining theory limits discount the value of settlement through delay and break-down risk; spite directly reduces the joint surplus by embedding negative interdependencies; transaction costs deduct resources required to

This changes the incentive structure: lawyers have limited upside from settlement efficiency but secure compensation regardless of outcome.

Table 3: Comparative Statics of Settlement Range: Baseline vs. Six Modifications

Modification	Change to Feasibility Condition (vs. baseline $E_w^T + E_h^T \leq u_w(c) + u_h(c)$)	Effect on Settlement Range	Request for Modification (after settlement)	Request for Modification (after trial)
Baseline	$E_w^T + E_h^T \leq u_w(c) + u_h(c)$	Full range of feasible custody/transfer combinations	Typically unnecessary unless beliefs/costs or enforceability change ex post.	Possible if beliefs converge and/or incremental second-trial costs appear.
#1 Bargaining theory limits	Effective surplus scaled/shifted by breakdown risk θ and discounting δ : $(1-\theta)(\delta_w + \delta_h)[u_w + u_h] + \theta(E_w^T + E_h^T) \geq E_w^T + E_h^T$	Range shrinks due to risk of breakdown (θ) and discounting (δ)	Unlikely unless θ falls (e.g., better mediation) or timing improves.	More likely if first trial reduces belief dispersion or raises $K_w + K_h$.
#2 Spite (negative altruism)	$E_w^T + E_h^T \leq u_w + u_h - (\lambda_w u_h + \lambda_h u_w)$	Range shrinks by subtraction of λ_i terms from total surplus	Unlikely unless spite parameters λ_i change (counseling, cooling-off).	Only via updated beliefs/costs; spite alone does not relax the condition.
#3 Transaction costs	$E_w^T + E_h^T \leq u_w + u_h - (S_w + S_h)$	Range reduced by explicit deduction of settlement costs ($S_w + S_h$)	Possible if court can approve terms that reduce $S_w + S_h$.	Likely if incremental modification costs, $K_w + K_h > S_w + S_h$.
#4 Commitment problems	$E_w^T + E_h^T \leq (1-\lambda)[u_w + u_h]$	Range scaled down proportionally by factor $(1-\lambda)$	Common: convert private deal into enforceable order to lower λ .	Likely if court can impose monitoring or enforcement that lowers λ .
#5 Legal limits (non-tractability, third-party rights)	Require $c \in C$ and $T \in [T_c, \bar{T}_c]$ and $E_w^T + E_h^T \leq u_w + u_h$	Range restricted by narrowing custody set C and transfer interval $[T_c, \bar{T}_c]$	Yes if court approval expands feasible transfers/outcomes beyond private C .	Yes—court may choose from a broader menu than parties can contract over.
#6 Agency problems (lawyer incentives)	$(E_w^T + \gamma_w) + (E_h^T + \gamma_h) \leq u_w + u_h - (\sigma_w + \sigma_h)$	Range shrinks due to inflated trial payoffs $(+\gamma_i)$ and reduced settlement surplus $(-\sigma_i)$	Possible if clients override counsel or fee terms change (reducing σ_i).	Likely if fee budgets deplete or reputational motives fade (lower γ_i).

negotiate and enforce agreements; commitment problems scale down the enforce- able surplus via the risk of defection; legal limits narrow the bargaining set by withholding alienable rights; and agency problems distort both trial and settlement payoffs through lawyer incentives. These distinctions matter for prediction: each deviation implies different conditions under which post-judgment modification requests are likely to arise. Table 3 summarizes the comparative statics across the six modifications to the divergent expectations model.

E. Conclusion

The central promise of the Coase theorem is that, when transaction costs are low and entitlements are well defined, private bargaining should yield efficient and durable outcomes regardless of the initial allocation of rights. In family law, Mnookin and Kornhauser's *Bargaining in the Shadow of the Law* framework adapted this insight to divorce, suggesting that default rules merely structure the bargaining set while efficiency is achieved through settlement. Yet the experience of family courts, and our evidence from the Los Angeles Superior Court, suggests that this Coasian optimism maybe overstated. Settlements in divorce are fragile, and requests for modification are routine.

This paper provides a thought experiment on extending the divergent expectations model to capture these deviations from the Coasian benchmark. Each friction, including informational asymmetries, interdependent utilities such as altruism or spite, transaction costs of enforcement and renegotiation, commitment problems in ongoing parental relationships, legal limits rooted in third-party rights, and the misaligned incentives of lawyers, can be modeled as a modification to the feasibility condition that determines whether settlement occurs. The common effect is to shrink the range of transfers and custody arrangements both parties prefer to trial. Narrower settlement ranges make trial more likely in the first instance and ensure that they are less durable even when settlements are reached. Once beliefs shift, enforcement costs accumulate, or statutory limits are invoked, the feasibility condition can fail, triggering petitions for modification.

The resulting picture is consistent with the observed high rate of renegotiation after judgment. Divorce bargaining is not a one-shot contract over divisible goods, but an ongoing bilateral monopoly over the fu-

ture of children, property, and financial support. Once expanded along the lines suggested by these Coasian limits, the divergent expectations model provides a broader explanation of why settlements unravel and why family courts devote so much of their docket to modification hearings. In this domain, the law matters not only for distribution but also for efficiency, and the Coase theorem serves less as a prediction than as a counterfactual benchmark against which the pervasive instability of family bargaining can be understood.

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