

Economic Analysis for Lawyers

*Carolina Academic Press
Law Advisory Board*



Gary J. Simson, Chairman
Dean, Mercer University School of Law

Raj Bhala
University of Kansas School of Law

Davison M. Douglas
Dean, William and Mary Law School

Paul Finkelman
Albany Law School

Robert M. Jarvis
*Shepard Broad Law Center
Nova Southeastern University*

Vincent R. Johnson
St. Mary's University School of Law

Peter Nicolas
University of Washington School of Law

Michael A. Olivas
University of Houston Law Center

Kenneth L. Port
William Mitchell College of Law

H. Jefferson Powell
Duke University School of Law

Michael P. Scharf
Case Western Reserve University School of Law

Michael Hunter Schwartz
*Dean, William H. Bowen School of Law
University of Arkansas at Little Rock*

Peter M. Shane
*Michael E. Moritz College of Law
The Ohio State University*

Economic Analysis for Lawyers

THIRD EDITION

Henry N. Butler

GEORGE MASON UNIVERSITY FOUNDATION PROFESSOR OF LAW AND
EXECUTIVE DIRECTOR, LAW & ECONOMICS CENTER,
GEORGE MASON UNIVERSITY SCHOOL OF LAW

Christopher R. Drahozal

JOHN M. ROUNDS PROFESSOR OF LAW,
UNIVERSITY OF KANSAS SCHOOL OF LAW

Joanna Shepherd

PROFESSOR OF LAW,
EMORY UNIVERSITY SCHOOL OF LAW



CAROLINA ACADEMIC PRESS

Durham, North Carolina

Copyright © 1998, 2006, 2014
Henry N. Butler, Christopher R. Drahozal, and Joanna Shepherd
All Rights Reserved

ISBN: 978-1-59460-997-8
LCCN: 2014943567

Carolina Academic Press
700 Kent Street
Durham, NC 27701
Telephone (919) 489-7486
Fax (919) 493-5668
www.cap-press.com

Printed in the United States of America

To Paige
–H.N.B.

To Julia
–C.R.D.

To Ted and Sophie
–J.S.

Contents

Table of Cases	xvii
Preface to the Third Edition	xxi
Preface to the Second Edition	xxiii
Preface to the First Edition	xxv
Chapter I · The Economics Perspective: Incentives Matter	3
Austan Goolsbee, <i>Where the Buses Run on Time</i>	3
A. Economic Behavior	5
1. Opportunity Costs, Economic Choices, and the Margin	5
2. Assumptions About Human Behavior	6
Michael C. Jensen and William H. Meckling, <i>The Nature of Man</i>	6
Notes and Questions	10
3. Assumptions about Firm Behavior	12
Matsushita Elec. Indus. Co. v. Zenith Radio Corp.	12
Notes and Questions	15
B. Property Rights and Exchange in a Free Market Economy	17
1. An Overview of the Efficient Property Rights System	18
2. Enforcement of Property Rights	19
Guido Calabresi & A. Douglas Melamed, <i>Property Rules, Liability Rules, and Inalienability: One View of the Cathedral</i>	20
Notes and Questions	21
3. Poorly Defined Property Rights	21
Garrett Hardin, <i>The Tragedy of the Commons</i>	21
Notes and Questions	22
Wronski v. Sun Oil Co.	22
Notes and Questions	24
4. Public Goods	26
5. Externalities, Property Rights, and the Coase Theorem	27
Miller v. Schoene	29
Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.	30
Notes and Questions	31
C. Legal Analysis and the Art of Economics	33
Eldred v. Ashcroft	33
Notes and Questions	37
D. Game Theory	39
Page v. United States	41
Notes and Questions	43

E. Positive versus Normative Economic Analysis	45
1. Positive Economic Analysis and Scientific Methodology	45
In Re Aluminum Phosphide Antitrust Litigation	46
Notes and Questions	50
2. Efficiency and Other Normative Goals	51
Chapter II · Markets and the Price System	55
A. The Law of Demand	56
1. Consumer Choice	56
2. Market Demand	57
B. The Law of Supply	58
1. The Opportunity Costs of Supply	58
2. Supply and Costs of Production	61
C. Equilibrium: Market Price and Quantity	62
1. Market Price and Quantity	63
Sedmak v. Charlie's Chevrolet, Inc.	63
Notes and Questions	65
2. Market Prices and Subjective Value	67
Peevyhouse v. Garland Coal & Mining Co.	69
Notes and Questions	72
D. Gains From Trade: Consumer Surplus and Producer Surplus	73
1. Mutually Beneficial Exchange	74
2. Individual Self-Interest, Free Markets, and Social Welfare:	
The Invisible Hand	75
Adam Smith, <i>An Inquiry into the Nature and Causes of the Wealth</i>	
<i>of Nations</i>	76
Leonard E. Read, <i>I, Pencil: My Family Tree as Told to Leonard E. Read</i>	76
Notes and Questions	78
3. Unequal Bargaining Power and the Limits of Mutually Beneficial	
Exchange	80
a. Unconscionability	80
Williams v. Walker Thomas Furniture Co.	80
Williams v. Walker Thomas Furniture Co. II	81
Notes and Questions	83
b. Modification and the Pre-Existing Duty Rule	86
Alaska Packers' Association v. Domenico	86
Notes and Questions	87
E. Changes in Demand and Supply	89
1. Changes in Demand	89
2. Changes in Supply	91
Competitive Enterprise Institute v. National Highway Traffic Safety	
Admin.	93
Notes and Questions	96
F. Price Controls	98
1. Price Ceilings	98
M. Kraus & Bros., Inc. v. United States	99
Notes and Questions	102
Jones v. Star Credit Corp.	104
Notes and Questions	106
2. Price Floors	106

3. The Quality of Products and Services in a Price-Controlled Market	108
G. Elasticity: The Responsiveness of Supply and Demand to a Price Change	109
1. Elasticity of Demand	109
2. Elasticity of Supply	114
3. Time and Elasticity	116
4. Tax Incidence	117
H. The Role of Prices	120
Friedrich von Hayek, <i>The Use of Knowledge in Society</i>	120
Notes and Questions	122
Chapter III · The Legislative Process and the Courts	125
A. Normative Grounds for Government Intervention	125
1. Market Failures	126
a. Information Problems	126
b. Externalities	127
c. Monopoly	128
d. Public Goods	129
2. Distributional Issues	129
B. Public Choice Economics	130
Fred S. McChesney, <i>Money for Nothing: Politicians, Rent Extraction, and Political Extortion</i>	131
Notes and Questions	134
City of Columbia v. Omni Outdoor Advertising, Inc.	137
Notes and Questions	140
West Lynn Creamery, Inc. v. Healy	142
Notes and Questions	146
C. The Economics of the Court System	147
1. Public Choice and the Courts	147
Republican Party of Minnesota v. White	148
Notes and Questions	155
2. Suit and Settlement	158
Kohls v. Duthie	159
Notes and Questions	162
3. The Economics of Court Procedures	167
a. Discovery	167
Hagemeyer North America, Inc. v. Gateway Data Sciences Corp.	168
Notes and Questions	171
b. Class Actions	172
In re: Bridgestone/Firestone, Inc.	173
Notes and Questions	175
Lane v. Facebook, Inc.	176
Notes and Questions	181
4. Arbitration	182
Carbajal v. H&R Block Tax Services, Inc.	182
Notes and Questions	183
Chapter IV · Externalities	185
A. Externalities	185
1. Negative Externalities	187
Orchard View Farms, Inc. v. Martin Marietta Aluminum, Inc.	189

Notes and Questions	194
2. Positive Externalities	195
B. Dealing with Externalities	196
1. The Assignment and Enforcement of Property Rights	197
a. Bargaining and the Coase Theorem	198
Prah v. Maretti	198
Notes and Questions	205
b. Transaction Costs	205
Boomer v. Atlantic Cement Co., Inc.	207
Notes and Questions	211
Spur Industries, Inc. v. Del E. Webb Development Co.	213
Notes and Questions	217
2. Corrective Taxes and Subsidies	217
3. Government Regulation	219
a. Direct Regulation Versus Corrective Taxes	220
b. Selling Rights to Pollute	220
C. Market Failures and Government Failures	222
Terry L. Anderson, <i>Markets and the Environment: Friends or Foes?</i>	223
Notes and Questions	229
Chapter V · Information Costs and Transaction Costs	231
A. Asymmetric Information and Market Responses	233
1. The Market for “Lemons”	233
2. Adverse Selection and Insurance Contracts	234
3. Reputational Bonds and Other Market Mechanisms for Disclosing Information About Quality	234
Benjamin Klein & Keith Leffler, <i>The Role of Market Forces in Assuring Contractual Performance</i>	235
Notes and Questions	239
B. Monitoring Contractual Performance: Agent-Principal Contracting	241
C. Opportunism: Market and Contractual Solutions	244
1. Firm-Specific Investments and the Appropriation of Quasi-Rents	246
Lake River Corp. v. Carborundum Co.	247
Notes and Questions	250
2. Franchising	254
Corenswet, Inc. v. Amana Refrigeration, Inc.	255
Benjamin Klein, <i>Transaction Cost Determinants of “Unfair” Contractual Arrangements</i>	259
Notes and Questions	263
D. Corporate Governance	266
1. Shareholder Voting and Rationally Ignorant Shareholders	267
2. Agency Costs and Owner/Manager Conflicts	268
3. The Contractual Theory of the Corporation	269
a. The Market for Corporate Control	270
Notes on the Market for Corporate Control	271
b. Product Market Competition	272
c. Capital Market Competition and Capital Structure	272
d. Corporate Performance and Executive Compensation	273
Kamin v. American Express Co.	274

Notes and Questions	276
e. Markets for Managers	277
f. The Board of Directors	277
g. Ownership Structure	278
h. Corporate Law and Fiduciary Duties	278
Jordan v. Duff and Phelps, Inc.	279
Notes and Questions	285
i. Corporate Federalism	286
Questions on Corporate Federalism	287
j. Corporate Federalization	287
Notes and Questions on Corporate Federalization	288
Chapter VI · Risk	291
A. Economics of Uncertainty and Risk	291
1. Basic Probability Theory	291
2. Expected Value and Variance	292
3. Expected Utility and Risk Preference	294
B. Insurance	298
1. Demand for Insurance	298
2. Supply of Insurance	299
a. Adverse Selection	299
Hall v. Continental Casualty Co.	300
Notes and Questions	302
b. Moral Hazard	304
Atwater Creamery Co. v. Western National Mutual Insurance Co.	304
Notes and Questions	308
c. Insurer's Duty to Settle	308
Mowry v. Badger State Mutual Casualty Co.	308
Notes and Questions	313
3. Self-Insurance	314
C. Risk and Market Prices	314
1. Financial Products	314
Richard A. Posner, <i>The Rights of Creditors of Affiliated Corporations</i>	315
2. Products and Services: Risk Allocation and Contract Law	316
a. Assumption of Risk	316
Avram Wisna v. New York University	317
Notes and Questions	319
b. The Bargaining Principle and Least-Cost Risk Avoider	319
c. The Allocation of Risk — Impracticability and Mistake	319
Eastern Air Lines v. Gulf Oil Corp.	320
Notes and Questions	321
Wilkin v. 1st Source Bank	322
Notes and Questions	324
3. Compensating Wage Differentials and Market Levels of Safety	325
4. Information, Risk, and Price Adjustments	327
D. Tort Law	327
1. Behavior Modification and Minimizing the Costs of Accidents	327
United States v. Carroll Towing Co.	328
Notes and Questions	330

2. Loss Spreading and Insurance	335
Greenman v. Yuba Power Products, Inc.	335
Notes and Questions	337
George Priest, <i>The Current Insurance Crisis and Modern Tort Law</i>	339
Notes and Questions	345
3. Allocative Efficiency	347
Doe v. Miles Laboratories, Inc.	348
Notes and Questions	351
4. Tort Damages and Incentives	351
a. Compensatory Damages	351
b. Punitive Damages	351
Mathias v. Accor Economy Lodging, Inc.	352
Notes and Questions	356
c. The Collateral Source Rule	358
Helfend v. Southern California Rapid Transit District	359
Notes and Questions	361
E. Risk Regulation	362
1. Cost-Benefit Analysis	362
UAW v. Occupational Safety & Health Administration	363
Notes and Questions	367
2. Measuring Risk: All Risks Are Relative	372
Corrosion Proof Fittings v. Environmental Protection Agency	372
Notes and Questions	378
3. Risk versus Risk	380
Competitive Enterprise Institute v. NHTSA	381
4. Risk Regulation Priorities	381
5. Political Economy of Health and Safety Regulation	382
Chapter VII · The Economics of Crime and Punishment	383
A. The Economics of Criminal Behavior	383
1. The Rational Choice Model	383
Gary Becker, <i>Crime and Punishment: An Economic Approach</i>	384
2. The Benefits and Costs from Crime	384
a. The Stigma of Criminal Activity	386
b. The Criminal's Discount Rate	386
c. The Economic Theory of Recidivism	386
d. Economics versus Criminology	386
e. Are Criminals Really Rational?	387
Ian Urbina and Sean D. Hammill, <i>As Economy Dips, Arrests for Shoplifting Soar</i>	387
Notes and Questions	389
B. Empirical Studies of the Economic Model of Crime	390
1. Police	391
2. Imprisonment	391
3. Capital Punishment	391
4. Gun Laws	391
5. Income	392
6. Income Inequality	392
7. Unemployment	392
Notes and Questions	393

C. The Economics of Law Enforcement	393
United States v. United States Gypsum Co.	394
Notes and Questions	398
1. Certainty versus Severity	399
United States v. Rajat K. Gupta	400
Notes and Questions	401
2. Fines versus Imprisonment	402
Tate v. Short	402
Notes and Questions	404
3. Extensions of the Basic Model	404
Richard A. Posner, <i>An Economic Theory of the Criminal Law</i>	404
a. Risk Preferences	407
b. Marginal Deterrence	408
c. Repeat Offenders	409
Ewing v. California	409
Notes and Questions	412
d. Discount Rates	412
United States v. Craig	412
Notes and Questions	414
D. Crime in the U.S.	414
Steven D. Levitt, <i>Understanding Why Crime Fell in the 1990s: Four Factors That Explain the Decline and Six That Do Not</i>	414
Notes and Questions	420
Chapter VIII · Labor Markets	421
A. Supply and Demand Analysis: An Overview	421
1. The Minimum Wage	421
2. Payroll Taxes	424
3. Fringe Benefits	425
B. Employers' Behavior	425
1. The Demand for Labor	426
2. Employer Investments	431
a. Hiring	431
Columbus Medical Services, LLC v. Thomas	432
Notes and Questions	439
b. Training	439
3. Discrimination	440
Wood v. City of San Diego	441
Notes and Questions	446
4. Employment At Will	450
Garcia v. Kankakee County Housing Authority	450
Notes and Questions	452
C. Employees' Behavior: The Supply of Labor	453
1. Human Capital Investments	454
O'Brien v. O'Brien	455
Notes and Questions	461
2. The Cobweb Model: Earnings Differences and the Demand for Education	462
3. Occupational Choice and Compensating Wage Differentials	464

4. Occupational Licensing	466
In Re: Doering	466
Notes and Questions	469
D. Labor Unions and Collective Bargaining	470
American Steel Erectors, Inc. v. Local Union No. 7, International Association of Bridge, Structural, Ornamental & Reinforcing Iron Workers	471
Notes and Questions	477
Chapter IX · Market Structure and Antitrust	481
A. Costs & Production	481
1. Short-Run Production	481
a. The Law of Diminishing Marginal Returns	482
b. Short-Run Costs	485
c. Changes in Costs of Production	488
d. Economies of Scale	488
2. Long-Run Production	489
B. Market Structures	492
1. Perfect Competition	492
a. Short-Run Individual Firm Behavior: Profit Maximization	493
b. Loss Minimization: The Shut-Down Decision	496
c. The Short-Run Supply Curve	497
d. Long-Run Firm Behavior: Industry Supply	498
e. The Economic Benefits of Competition	502
2. Monopoly	503
a. Profit Maximizing Price and Quantity	503
b. Barriers to Entry	508
United States v. Microsoft Corp.	508
Notes and Questions	512
c. Price Discrimination	513
d. Predatory Pricing	515
Matsushita Elec. Indus. Co. v. Zenith Radio Corp.	516
e. The Social Costs of Monopoly	517
Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP	520
Notes and Questions	521
3. More Realistic Models of Competition: Differentiated Products Markets & Oligopoly	523
a. Competition with Differentiated Products	524
Leegin Creative Leather Products, Inc. v. PSKS, Inc.	526
Notes and Questions	531
b. Oligopoly	537
Bell Atlantic Corporation v. Twombly	538
Palmer v. BRG of Georgia	540
Notes and Questions	542
John M. Connor, <i>Global Cartels Redux: The Amino Acid Lysine Antitrust Litigation</i>	545
Notes and Questions	547
Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.	554
Notes and Questions	562

Chapter X · Principles of Valuation	565
A. Prejudgment Interest	565
Gorenstein Enterprises, Inc. v. Quality Care-USA, Inc.	566
Notes and Questions	567
United Telecommunications, Inc. v. American Television and Communications Corp.	568
B. Discounted Present Value	569
1. The Present Value Formula	570
2. Rules of Thumb for Determining Present Value	571
a. The Perpetuity Rule	571
b. The Rule of 72	572
3. Discounting and Litigation	573
a. Determining the Relevant Future Stream of Economic Benefits	574
Haugan v. Haugan	574
Notes and Questions	577
Diocese of Buffalo v. State of New York	578
Notes and Questions	581
b. Determining the Proper Interest Rate	582
Trevino v. United States	582
Notes and Questions	585
c. Pulling It All Together	586
O’Shea v. Riverway Towing Co.	587
Notes and Questions	591
C. The Value of Life	591
1. Economic Value of Life	592
Cappello v. Duncan Aircraft Sales of Florida	592
Notes and Questions	593
Kip Viscusi, <i>The Value of Life</i>	595
2. The Hedonic Value of Life	596
Mercado v. Ahmed	597
Notes and Questions	600
D. Valuation of Close Corporations	601
1. Discounted Future Returns Approach	603
Kleinwort Benson, Ltd. v. Silgan Corp.	604
Notes and Questions	608
2. Approaches Using Current or Historical Data	610
Central Trust Co. v. United States	612
Notes and Questions	620
Glossary	621
Index	641

Table of Cases

- Alaska Packers' Association v. Domenico**, 86–89
- Alleghany Corp. v. Kirby**, 181
- Amanda Acquisition Corp. v. Universal Foods Corp.**, 287
- American Steel Erectors, Inc. v. Local Union No. 7, International Association of Bridge, Structural, Ornamental & Reinforcing Iron Workers**, 471–77
- Amino Acid Lysine Antitrust Litigation**, 545–59
- Arizona Governing Committee for Tax Deferred Annuity & Deferred Compensation Plans v. Norris**, 443, 445
- Atwater Creamery Co. v. Western National Mutual Insurance Co.**, 304–08
- Bell Atlantic Corp. v. Twombly**, 538–40
- Boomer v. Atlantic Cement Co. Inc.**, 207–13
- Broadcast Music, Inc. v. Columbia Broadcasting System Inc.**, 554–62
- Cappello v. Duncan Aircraft Sales of Florida**, 592–93
- Carbajal v. H&R Block Tax Services, Inc.**, 182–83
- Central Trust Co v. United States**, 612–20
- City of Columbia v. Omni Outdoor Advertising, Inc.**, 137–40
- City of Los Angeles, Department of Water & Power v. Manhart**, 443–47
- Columbus Medical Services, LLC v. Thomas**, 432–39
- Competitive Enterprise Institute v. National Highway Safety Admin.**, 93–96, 381, 591
- Connell Constr. Co. v. Plumbers Local 100**, 475, 477
- Consultants & Designers, Inc. v. Butler Serv. Group, Inc.**, 436–38
- Continental T.V., Inc. v. GTE Sylvania, Inc.**, 244, 532–33
- Corenswet, Inc. v. Amana Refrigeration, Inc.**, 255–58, 264
- Corrosion Proof Fittings v. Environmental Protection Agency**, 372–78
- Craigsmiles v. Giles**, 141–42
- Daubert v. Merrell Dow Pharmaceuticals, Inc.**, 47, 49–51, 601
- Diocese of Buffalo v. State of New York**, 578–81
- Doe v. Miles Laboratory, Inc.**, 348–51
- Eastern Air Lines v. Gulf Oil Corp.**, 320–21
- Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.**, 139–41, 520
- Eldred v. Ashcroft**, 33–39
- Escola v. Coca Cola Bottling Co.**, 337
- Ewing v. California**, 409–12
- Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.**, 30–33, 201–02, 205
- Garcia v. Kankakee County Housing Authority**, 450–52
- Goldfarb v. Virginia State Bar**, 470, 551–52
- Gorenstein Enterprises, Inc. v. Quality Care-USA, Inc.**, 566–67
- Greenman v. Yuba Power Products, Inc.**, 335–37, 339, 340
- Hagemeyer North America, Inc. v. Gateway Data Sciences Corp.**, 168–72

- Hall v. Continental Casualty Co.**, 300–02
- Hasty v. Rent-A-Driver, Inc.**, 435, 438
- Haugan v. Haugan**, 461, 574–77, 578, 586
- Helfend v. Southern California Rapid Transit District**, 359–61
- Henningsen v. Bloomfield Motors**, 84–86
- Hickman v. Taylor**, 167
- In re Aluminum Phosphide Antitrust Litigation**, 46–51
- In re Doering**, 466–69
- In re Rhone-Poulenc Rorer, Inc.**, 175–76
- In re Bridgestone/Firestone, Inc.**, 173–75
- Jones v. Star Credit Corp.**, 84, 104–06
- Jordan v. Duff and Phelps, Inc.**, 279–85
- Joy v. North**, 286
- Kamilewicz v. Bank of Boston**, 181
- Kamin v. American Express Co.**, 274–76
- Kleinwort Benson, Ltd. v. Silgan Corp.**, 604–10
- Kohls v. Duthie**, 159–63
- Lake River Corp. v. Carborundum Co.**, 247–52
- Lane v. Facebook, Inc.**, 176–81
- Leegin Creative Leather Products, Inc. v. PSKS, Inc.**, 526–36, 550
- Liggett Co. v. Lee**, 287
- Lochner v. New York**, 142
- M. Kraus & Bros., Inc. v. United States**, 99–104
- Mathias v. Accor Economy Lodging, Inc.**, 352–56
- Matsushita Elec. Indus. Co. v. Zenith Radio Corp.**, 12-15, 516, 521
- McPeck v. Ashcroft**, 169–71
- Mercado v. Ahmed**, 597–601
- Miller v. Schoene**, 29
- Morris v. Schoonfield**, 403
- Mowry v. Badger State Mutual Casualty Co.**, 308–13
- North Carolina Board of Dental Examiners v. Federal Trade Commission**, 470
- O'Brien v. O'Brien**, 455–61
- O'Shea v. Riverway Towing Co.**, 587–91
- Orchard View Farms, Inc. v. Martin Marietta Aluminum, Inc.**, 189–94
- Page v. United States**, 41–43
- Palmer v. BRG of Georgia**, 540–42
- Parker v. Brown**, 138–41
- Peevyhouse v. Garland Coal & Mining Co.**, 69–72
- Perkins v. F.I.E. Corp.**, 347
- Perma Life Mufflers, Inc. v. International Parts Corp.**, 264
- Power v. Harris**, 142
- Prah v. Maretti**, 198–204
- ProCD, Inc. v. Zeidenberg**, 513–14
- Republican Party of Minnesota v. White**, 148–55
- Reynolds Metals Co. v. Lampert**, 190, 194
- Richman v. Charter Arms Corp.**, 346
- Roe v. Wade**, 419
- Rowe Entm't, Inc. v. William Morris Agency, Inc.**, 169–71
- Schiller & Schmidt, Inc. v. Nordisco Corp.**, 51
- Sedmak v. Charlie's Chevrolet, Inc.**, 63–67
- Shepard v. Superior Court**, 338–39
- Sherwood v. Walker**, 323–24
- Spur Industries, Inc. v. Del E. Webb Development Co.**, 213–17
- State Oil Co. v. Khan**, 528, 533–34
- Tate v. Short**, 402–04
- Trevino v. United States**, 582–86
- UAW v. Occupational Safety & Health Administration**, 363–67, 594
- United States v. Andreas**, 548–49
- United States v. Apple, Inc.**, 549–50
- United States v. Carroll Towing Co.**, 328–30, 365
- United States v. Craig**, 412–14
- United States v. Hutcheson**, 473–74
- United States v. Microsoft Corp.**, 508–13, 521
- United States v. Miller**, 68
- United States v. Rajat K. Gupta**, 400–01
- United States v. Socony-Vacuum Oil**, 541, 559
- United States v. Topco Associates Inc.**, 521, 541–42, 556, 563

- United States v. United States Gypsum Co.**, 394–98
- United Telecommunications, Inc. v. American Television and Communications Corp.**, 568–69
- Vande Zande v. State of Wisconsin Department of Administration**, 447–48
- Vantage Tech., LLC v. Cross**, 435–36
- Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP**, 520–21
- Weinberger v. UOP, Inc.**, 609
- West Lynn Creamery, Inc. v. Healy**, 142–46, 147
- Wilkin v. 1st Source Bank**, 322–24
- Williams v. Walker Thomas Furniture Co.**, 80–81, 105, 264
- Williams v. Walker Thomas Furniture Co. II**, 81–83, 84
- Wood v. City of San Diego**, 441–47
- Wronski v. Sun Oil Co.**, 22–24
- Wyoming v. Oklahoma**, 146
- Zubulake v. U.B.S. Warburg, LLC**, 169, 170

Preface to the Third Edition

This is a microeconomics book that relies on numerous examples from the law and public policy to illustrate practical economic concepts in action. As explained in the prior prefaces, the first three chapters are foundational and should be taught first. The basic narrative is to explain how ideal markets operate, the consequences of interfering with market price adjustments, a consideration of “market failures” as a justification for government intervention in markets, and then the harsh reality that government interventions are often as imperfect as the markets they aspire to correct.

After the first three chapters, subsequent chapters can be taught in whatever order works best. In essence, chapters IV through X are free standing. This third edition includes two new chapters—Chapter VII on Crime and Punishment and Chapter VIII on Labor Markets. These chapters were added in response to suggestions by many of the hundreds of judges who have attended the Economics Institute for Judges offered by the Law & Economics Center at George Mason University School of Law.

We acknowledge the valuable suggestions of professors who adopted the second edition. In particular, Bruce Johnsen and James Cooper have provided detailed suggestions and Cooper helped revise Chapter IX on Market Structure and Antitrust. Several research assistants helped update examples and cases. The George Mason team consisted of Nate Harris, Matt Wheatley, Mark Weiss, Allen Gibby, Sam Banks, Maurio Fiore, Christopher Mufarriage, Jason Greaves, Mark Ericson, and Taylor Hoverman. The Emory team consisted of Robin Caskey, Steve Ferketic, Kasia Hebda, Sarah O’Donohue, Caitlin Pardue, Luka Stanic, and Dimitri Dzagnidze.

Henry N. Butler
Arlington, Virginia

Christopher R. Drahozal
Lawrence, Kansas

Joanna Shepherd
Atlanta, Georgia

Preface to the Second Edition

This second edition continues to reflect our belief in the value of the building block approach to teaching economics to lawyers and law students, and in the usefulness of cases as a supplement to that approach. Our use of the first edition in class, and the feedback from our students, has reinforced those beliefs. Our goal in preparing this second edition has been to reorganize and streamline the materials in response to comments from professors, law students, and judges, while staying true to the pedagogical approach of the first edition.

The first three chapters remain the core materials and should be covered first. Those chapters cover much of the same ground as in the first edition, but with a somewhat different organization. Chapter 1 introduces the economics approach, examining such topics as the economist's assumptions about human and firm behavior and the fundamental concepts of opportunity cost and property rights. Among the new material in the chapter is a note summarizing some of the recent scholarship on behavioral law and economics. Chapter 2 develops the basic supply-and-demand model in a variety of market and legal settings. Chapter 3 examines the economics of government regulation (and government failure—i.e., public choice economics), and includes a new section on the economics of the court system.

The remaining chapters may be covered in whatever order the instructor prefers. As with the first edition, the organization is by economic concept rather than by substantive legal area. Chapter 4 discusses externalities and legal responses to externalities. Chapter 5 combines two chapters from the first edition (on the economics of information and on organizational economics) into a single chapter dealing with information costs and transaction costs. The remaining three chapters have been updated but largely follow the same structure as their counterparts in the first edition. Chapter 6 discusses risk, Chapter 7 deals with competition and monopoly, and Chapter 8 addresses valuation issues.

By design, this edition is substantially shorter than the first edition. We have accomplished this both by excluding some topics covered in the first edition, and by a careful editing of the cases to focus on the key aspects (both legal and factual) of the case. The result, we hope, is that reading assignments will be of a more manageable size but without any significant loss of substance. There remains ample material for a one semester course in law and economics.

Thanks to our families for their support and patience with us during this revision. In addition, we very much appreciate the research assistance of Eric Hatchett, Matt Koenigsdorf, and Sean McGivern, and financial support from the University of Kansas School of Law.

Henry N. Butler
Orange, California

Christopher R. Drahozal
Lawrence, Kansas

Preface to the First Edition

This casebook is designed to help law students and lawyers learn the principles of microeconomics. A quick review of the table of contents reveals that economics concepts provide the organizational structure of the book. Instead of organizing around substantive areas of the law, it follows the building block approach used in most successful principles of economics textbooks. This proven approach to teaching economics differs from other law-and-economics casebooks that tend to focus on applications of economics to legal issues rather than teaching economics. After fifteen years of teaching economics—often to law students, law school professors, lawyers, and judges—I am convinced of the pedagogical advantages of this approach. For the many law professors who share this view and have been forced to supplement principles of economics textbooks with cases, I believe that this casebook offers a more convenient and coherent alternative.

My involvement with this casebook started as an effort to revise the first edition of *Quantitative Methods for Lawyers* by Professor Steven M. Crafton and Margaret F. Brinig of George Mason University School of Law. Their ambitious effort to create a casebook introduction to economics, finance, accounting, statistics, and econometrics has met with considerable success as judged by adoptions at numerous leading law schools. Nevertheless, my interest in these materials quickly turned to concentrating on a more traditional approach to teaching economics. The result is a very different type of casebook than Crafton and Brinig's initial effort. Keith Sipe, the publisher of Carolina Academic Press, has encouraged me to incorporate some materials from the first edition of *Quantitative Methods for Lawyers* and I have done so in numerous areas of this casebook. It is our hope that many of the materials presented here will be incorporated in the second edition of *Quantitative Methods for Lawyers* by Crafton and Butler. The materials remain a "work in progress." I encourage you to send your comments, criticisms, and suggestions for improvements of subsequent editions.

This casebook is not intended to be an encyclopedic treatise on either the principles of economics or the economic analysis of law. Some topics typically covered in a principles textbook are not found here; similarly, numerous legal issues susceptible to economic analysis are not covered. Nevertheless, there is plenty of material for a typical one-semester course. I encourage you to work through the first five chapters and then choose chapters according to your interests. Figures are available in PowerPoint. Many of the edited cases presented here are longer than one would expect if they were excerpted in a specialized casebook on their particular area of the law. The pedagogical reason for this is that I was concerned that first or second year law students needed to have more information about the particular substantive law (especially in some regulatory cases) in order to understand the economic issues. I have attempted to ease this pain by minimizing and shortening many case citations in the cases presented.

Numerous individuals have helped me complete this book. I am especially grateful to two individuals. Geoffrey Lysaught, a J.D./Ph.D. in finance student at the University of Kansas, has been involved in every aspect of the project. He was especially helpful on the finance and risk issues covered in Chapters IV, IX, and XI. Christopher Drahozal, a colleague in the School of Law, provided detailed comments and suggestions on the entire manuscript. Geoff and Chris, thank you! I also acknowledge the valuable contributions of research assistants Gary Eastman, Matt Hoy, and Alok Srivastava. The Smith Richardson Foundation provided essential financial support at the start of this project.

I have used earlier drafts of these materials in my Law and Economics classes as well as in the *Economics Institutes for State Judges* offered by the University of Kansas Law and Organizational Economics Center (LOEC). Comments from law students, professors in the *Economics Institutes for State Judges* (Barry Baysinger, Keith Chauvin, and Maurice Joy of Kansas; Terry L. Anderson of PERC and the Hoover Institution; and W. Kip Viscusi of Harvard Law School), and judges have improved the final product. I would like to offer my thanks to three judges—Victor T. Barrera of California, Richard T. Jessen of Minnesota, and Donald S. Owens of Michigan—who took great pride in their ability to spot typos. Accordingly, any remaining typos are their responsibility.

Finally, I wish to express my sincerest gratitude and appreciation to Cathy Lysaught and Missy Amlong at the LOEC for their loyal and tireless assistance. They “hung in there” during the long and tedious process of compiling these materials.

Henry N. Butler
Lawrence, Kansas