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
To Paige
–H.N.B.

To Julia
–C.R.D.

To Ted and Sophie
–J.S.
Contents

Table of Cases xvi
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, Where the Buses Run on Time 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, The Nature of Man 6
     Notes and Questions 10
  3. Assumptions about Firm Behavior 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, Property Rules, Liability Rules,
     and Inalienability: One View of the Cathedral 20
     Notes and Questions 21
  3. Poorly Defined Property Rights 21
     Garrett Hardin, The Tragedy of the Commons 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, An Inquiry into the Nature and Causes of the Wealth
      of Nations 76
      Leonard E. Read, I, Pencil: My Family Tree as Told to Leonard E. Read 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
      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
CONTENTS

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, *The Use of Knowledge in Society* 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
      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
       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, *The Role of Market Forces in
       Assuring Contractual Performance* 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
       Corenswe, Inc. v. Amana Refrigeration, Inc.                                                   255
       Benjamin Klein, *Transaction Cost Determinants of “Unfair”
       Contractual Arrangements* 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
Chapter VI · Risk

A. Economics of Uncertainty and Risk
   1. Basic Probability Theory
   2. Expected Value and Variance
   3. Expected Utility and Risk Preference

B. Insurance
   1. Demand for Insurance
   2. Supply of Insurance
      a. Adverse Selection
      b. Moral Hazard
      c. Insurer’s Duty to Settle
         Hall v. Continental Casualty Co.
         Mowry v. Badger State Mutual Casualty Co.
   3. Self-Insurance

C. Risk and Market Prices
   1. Financial Products
   2. Products and Services: Risk Allocation and Contract Law
      a. Assumption of Risk
      b. The Bargaining Principle and Least-Cost Risk Avoider
      c. The Allocation of Risk — Impracticability and Mistake
         Eastern Air Lines v. Gulf Oil Corp.
   3. Compensating Wage Differentials and Market Levels of Safety
   4. Information, Risk, and Price Adjustments

D. Tort Law
   1. Behavior Modification and Minimizing the Costs of Accidents
      United States v. Carroll Towing Co.
## CONTENTS

<table>
<thead>
<tr>
<th>2. Loss Spreading and Insurance</th>
<th>335</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greenman v. Yuba Power Products, Inc.</td>
<td>335</td>
</tr>
<tr>
<td>Notes and Questions</td>
<td>337</td>
</tr>
<tr>
<td>George Priest, <em>The Current Insurance Crisis and Modern Tort Law</em></td>
<td>339</td>
</tr>
<tr>
<td>Notes and Questions</td>
<td>345</td>
</tr>
<tr>
<td>3. Allocative Efficiency</td>
<td>347</td>
</tr>
<tr>
<td>Doe v. Miles Laboratories, Inc.</td>
<td>348</td>
</tr>
<tr>
<td>Notes and Questions</td>
<td>351</td>
</tr>
<tr>
<td>4. Tort Damages and Incentives</td>
<td>351</td>
</tr>
<tr>
<td>a. Compensatory Damages</td>
<td>351</td>
</tr>
<tr>
<td>b. Punitive Damages</td>
<td>351</td>
</tr>
<tr>
<td>Mathias v. Accor Economy Lodging, Inc.</td>
<td>352</td>
</tr>
<tr>
<td>Notes and Questions</td>
<td>356</td>
</tr>
<tr>
<td>c. The Collateral Source Rule</td>
<td>358</td>
</tr>
<tr>
<td>Helfend v. Southern California Rapid Transit District</td>
<td>359</td>
</tr>
<tr>
<td>Notes and Questions</td>
<td>361</td>
</tr>
<tr>
<td>E. Risk Regulation</td>
<td>362</td>
</tr>
<tr>
<td>1. Cost-Benefit Analysis</td>
<td>362</td>
</tr>
<tr>
<td>UAW v. Occupational Safety &amp; Health Administration</td>
<td>363</td>
</tr>
<tr>
<td>Notes and Questions</td>
<td>367</td>
</tr>
<tr>
<td>2. Measuring Risk: All Risks Are Relative</td>
<td>372</td>
</tr>
<tr>
<td>Corrosion Proof Fittings v. Environmental Protection Agency</td>
<td>372</td>
</tr>
<tr>
<td>Notes and Questions</td>
<td>378</td>
</tr>
<tr>
<td>3. Risk versus Risk</td>
<td>380</td>
</tr>
<tr>
<td>Competitive Enterprise Institute v. NHTSA</td>
<td>381</td>
</tr>
<tr>
<td>4. Risk Regulation Priorities</td>
<td>381</td>
</tr>
<tr>
<td>5. Political Economy of Health and Safety Regulation</td>
<td>382</td>
</tr>
</tbody>
</table>

### Chapter VII · The Economics of Crime and Punishment 383

#### A. The Economics of Criminal Behavior 383

1. The Rational Choice Model 383
   - Gary Becker, *Crime and Punishment: An Economic Approach* 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, *As Economy Dips, Arrests for Shoplifting Soar* 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
CONTENTS

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
      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, *Understanding Why Crime Fell in the 1990s: Four Factors That Explain the Decline and Six That Do Not* 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
Chapter IX · Market Structure and Antitrust

A. Costs & Production

1. Short-Run Production
   a. The Law of Diminishing Marginal Returns
   b. Short-Run Costs
   c. Changes in Costs of Production
   d. Economies of Scale

2. Long-Run Production

B. Market Structures

1. Perfect Competition
   a. Short-Run Individual Firm Behavior: Profit Maximization
   b. Loss Minimization: The Shut-Down Decision
   c. The Short-Run Supply Curve
   d. Long-Run Firm Behavior: Industry Supply
   e. The Economic Benefits of Competition

2. Monopoly
   a. Profit Maximizing Price and Quantity
   b. Barriers to Entry
      United States v. Microsoft Corp.
      Notes and Questions
   c. Price Discrimination
   d. Predatory Pricing
      Notes and Questions
   e. The Social Costs of Monopoly
      Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP
      Notes and Questions

3. More Realistic Models of Competition: Differentiated Products Markets & Oligopoly
   a. Competition with Differentiated Products
      Leegin Creative Leather Products, Inc. v. PSKS, Inc.
      Notes and Questions
   b. Oligopoly
      Bell Atlantic Corporation v. Twombly
      Palmer v. BRG of Georgia
      Notes and Questions
      John M. Connor, Global Cartels Redux: The Amino Acid Lysine
      Antitrust Litigation
      Notes and Questions
      Notes and Questions
<table>
<thead>
<tr>
<th>Case</th>
<th>Page(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska Packers’ Association v. Domenico</td>
<td>86–89</td>
</tr>
<tr>
<td>Alleghany Corp. v. Kirby</td>
<td>181</td>
</tr>
<tr>
<td>Amanda Acquisition Corp. v. Universal Foods Corp.</td>
<td>287</td>
</tr>
<tr>
<td>American Steel Erectors, Inc. v. Local Union No. 7, International Union of Bridge, Structural, Ornamental &amp; Reinforcing Iron Workers</td>
<td>471–77</td>
</tr>
<tr>
<td>Amino Acid Lysine Antitrust Litigation</td>
<td>545–59</td>
</tr>
<tr>
<td>Atwater Creamery Co. v. Western National Mutual Insurance Co.</td>
<td>304–08</td>
</tr>
<tr>
<td>Bell Atlantic Corp. v. Twombly</td>
<td>538–40</td>
</tr>
<tr>
<td>Boomer v. Atlantic Cement Co. Inc.</td>
<td>207–13</td>
</tr>
<tr>
<td>Broadcast Music, Inc. v. Columbia Broadcasting System Inc.</td>
<td>554–62</td>
</tr>
<tr>
<td>Cappello v. Duncan Aircraft Sales of Florida</td>
<td>592–93</td>
</tr>
<tr>
<td>Carbajal v. H&amp;R Block Tax Services, Inc.</td>
<td>182–83</td>
</tr>
<tr>
<td>Central Trust Co v. United States</td>
<td>612–20</td>
</tr>
<tr>
<td>City of Columbia v. Omni Outdoor Advertising, Inc.</td>
<td>137–40</td>
</tr>
<tr>
<td>City of Los Angeles, Department of Water &amp; Power v. Manhart</td>
<td>443–47</td>
</tr>
<tr>
<td>Columbus Medical Services, LLC v. Thomas</td>
<td>432–39</td>
</tr>
<tr>
<td>Competitive Enterprise Institute v. National Highway Safety Admin.</td>
<td>93–96, 381, 591</td>
</tr>
<tr>
<td>Connell Constr. Co. v. Plumbers Local</td>
<td>100, 475, 477</td>
</tr>
<tr>
<td>Consultants &amp; Designers, Inc. v. Butler Serv. Group, Inc.</td>
<td>436–38</td>
</tr>
<tr>
<td>Continental T.V., Inc. v. GTE Sylvania, Inc.</td>
<td>244, 532–33</td>
</tr>
<tr>
<td>Corenswey, Inc. v. Amana Refrigeration, Inc.</td>
<td>255–58, 264</td>
</tr>
<tr>
<td>Corrosion Proof Fittings v. Environmental Protection Agency</td>
<td>372–78</td>
</tr>
<tr>
<td>Craigmiles v. Giles</td>
<td>141–42</td>
</tr>
<tr>
<td>Daubert v. Merrell Dow Pharmaceuticals, Inc.</td>
<td>47, 49–51, 601</td>
</tr>
<tr>
<td>Diocese of Buffalo v. State of New York</td>
<td>578–81</td>
</tr>
<tr>
<td>Doe v. Miles Laboratory, Inc.</td>
<td>348–51</td>
</tr>
<tr>
<td>Eastern Air Lines v. Gulf Oil Corp.</td>
<td>320–21</td>
</tr>
<tr>
<td>Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.</td>
<td>139–41, 520</td>
</tr>
<tr>
<td>Eldred v. Ashcroft</td>
<td>33–39</td>
</tr>
<tr>
<td>Escola v. Coca Cola Bottling Co.</td>
<td>337</td>
</tr>
<tr>
<td>Ewing v. California</td>
<td>409–12</td>
</tr>
<tr>
<td>Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.</td>
<td>30–33, 201–02, 205</td>
</tr>
<tr>
<td>Garcia v. Kankakee County Housing Authority</td>
<td>450–52</td>
</tr>
<tr>
<td>Goldfarb v. Virginia State Bar</td>
<td>470, 551–52</td>
</tr>
<tr>
<td>Gorenstein Enterprises, Inc. v. Quality Care-USA, Inc.</td>
<td>566–67</td>
</tr>
<tr>
<td>Greenman v. Yuba Power Products, Inc.</td>
<td>335–37, 339, 340</td>
</tr>
<tr>
<td>Hagemeyer North America, Inc. v. Gateway Data Sciences Corp.</td>
<td>168–72</td>
</tr>
</tbody>
</table>
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
McPeek 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. Maretii, 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
Schiller & Schmidt, Inc. v. Nordisco Corp., 51
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
<table>
<thead>
<tr>
<th>Case</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States v. United States Gypsum Co.</td>
<td>394–98</td>
</tr>
<tr>
<td>United Telecommunications, Inc. v. American Television and Communi-</td>
<td>568–69</td>
</tr>
<tr>
<td>cations Corp.</td>
<td></td>
</tr>
<tr>
<td>Vande Zande v. State of Wisconsin Department of Administration</td>
<td>447–48</td>
</tr>
<tr>
<td>Vantage Tech., LLC v. Cross</td>
<td>435–36</td>
</tr>
<tr>
<td>Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP</td>
<td>520–21</td>
</tr>
<tr>
<td>Weinberger v. UOP, Inc.</td>
<td>609</td>
</tr>
<tr>
<td>West Lynn Creamery, Inc. v. Healy</td>
<td>142–46, 147</td>
</tr>
<tr>
<td>Wilkin v. 1st Source Bank</td>
<td>322–24</td>
</tr>
<tr>
<td>Williams v. Walker Thomas Furniture Co.</td>
<td>80–81, 105, 264</td>
</tr>
<tr>
<td>Williams v. Walker Thomas Furniture Co. II</td>
<td>81–83, 84</td>
</tr>
<tr>
<td>Wood v. City of San Diego</td>
<td>441–47</td>
</tr>
<tr>
<td>Wronski v. Sun Oil Co.</td>
<td>22–24</td>
</tr>
<tr>
<td>Wyoming v. Oklahoma</td>
<td>146</td>
</tr>
<tr>
<td>Zubulake v. U.B.S. Warburg, LLC</td>
<td>169, 170</td>
</tr>
</tbody>
</table>
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