

# **Economic Analysis for Lawyers**

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# **Economic Analysis for Lawyers**

*Second Edition*

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ARGYROS SCHOOL OF BUSINESS & ECONOMICS  
CHAPMAN UNIVERSITY

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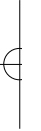
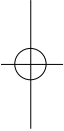
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*To Chris, Taylor, Hank, Andy, Sarah and Paige*

HNB

*To Julia*

CRD



# Contents

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Table of Cases	xv
Preface to the Second Edition	xvii
Preface to the First Edition	xix
<b>Chapter I The Economics Perspective: Incentives Matter</b>	
A. Economic Behavior	4
1. Opportunity Costs, Economic Choices, and the Margin	4
2. Assumptions about Human Behavior	5
The Nature of Man	5
Notes and Questions	9
3. Assumptions about Firm Behavior	11
Matsushita Elec. Indus. Co. v. Zenith Radio Corp.	11
Notes and Questions	14
B. Property Rights and Exchange in a Free Market Economy	17
1. An Overview of the Efficient Property Rights System	17
2. Enforcement of Property Rights	19
Property Rules, Liability Rules, and Inalienability:	
One View of the Cathedral	19
Notes and Questions	20
3. Poorly Defined Property Rights	20
The Tragedy of the Commons	21
Notes and Questions	21
Wronski v. Sun Oil Co.	22
Notes and Questions	23
4. Public Goods	24
5. Externalities, Property Rights, and the Coase Theorem	25
Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.	27
Notes and Questions	29
C. Legal Analysis and the Art of Economics	30
Eldred v. Ashcroft	31
Notes and Questions	35
D. Game Theory	37
Page v. United States	39
Notes and Questions	41
E. Positive versus Normative Economic Analysis	43
1. Positive Economic Analysis and Scientific Methodology	43
In Re Aluminum Phosphide Antitrust Litigation	44
Notes and Questions	48
2. Efficiency and Other Normative Goals	50

**Chapter II Markets and the Price System**

A. The Law of Demand	53
1. Consumer Choice	54
2. Market Demand	55
B. The Law of Supply	56
1. The Opportunity Costs of Supply	56
2. Supply and Costs of Production	59
C. Equilibrium: Market Price and Quantity	60
1. Market Price and Quantity	61
Sedmak v. Charlie's Chevrolet, Inc.	61
Notes and Questions	63
2. Market Prices and Subjective Value	65
Peevyhouse v. Garland Coal & Mining Co.	67
Notes and Questions	70
D. Gains From Trade: Consumer Surplus and Producer Surplus	71
1. Mutually-Beneficial Exchange	72
2. Individual Self-Interest, Free Markets, and Social Welfare:	
The Invisible Hand	73
An Inquiry into the Nature and Causes of the Wealth of Nations	74
Notes and Questions	74
3. Unequal Bargaining Power and the Limits of Mutually Beneficial Exchange	75
a. Unconscionability	76
Williams v. Walker Thomas Furniture Co.	76
Williams v. Walker Thomas Furniture Co. II	77
Notes and Questions	79
b. Modification and the Pre-Existing Duty Rule	81
Alaska Packers' Association v. Domenico	81
Notes and Questions	83
E. Changes in Demand and Supply	85
1. Changes in Demand	85
2. Changes in Supply	87
Competitive Enterprise Institute v. National Highway Traffic Safety Admin.	88
Notes and Questions	91
F. Price Controls	93
1. Price Ceilings	94
M. Kraus & Bros., Inc. v. United States	94
Notes and Questions	97
Jones v. Star Credit Corp.	99
Notes and Questions	101
2. Price Floors	102
3. The Quality of Products and Services in a Price Controlled Market	103
G. Elasticity: The Responsiveness of Supply and Demand to a Price Change	104
1. Elasticity of Demand	104
2. Elasticity of Supply	109
3. Time and Elasticity	110
4. Tax Incidence	111
H. The Role of Prices	115
The Use of Knowledge in Society	115
Notes and Questions	116



## CONTENTS

ix

<b>Chapter III The Legislative Process and the Courts</b>	
A. Normative Grounds for Government Intervention	120
1. Market Failures	120
a. Information Problems	120
b. Externalities	121
c. Monopoly	122
d. Public Goods	123
2. Distributional Issues	123
B. Public Choice Economics	124
Money for Nothing: Politicians, Rent Extraction, and Political Extortion	125
Notes and Questions	128
City of Columbia v. Omni Outdoor Advertising, Inc.	131
Notes and Questions	135
West Lynn Creamery, Inc. v. Healy	137
Notes and Questions	141
C. The Economics of the Court System	142
1. Public Choice and the Courts	142
Republican Party of Minnesota v. White	142
Notes and Questions	149
2. Suit and Settlement	151
Kohls v. Duthie	152
Notes and Questions	155
3. The Economics of Court Procedures	158
a. Discovery	158
Hagemeyer North America, Inc. v. Gateway Data Sciences Corp.	159
Notes and Questions	162
b. Class Actions	163
In re: Bridgestone/Firestone, Inc.	164
Notes and Questions	166
Mars Steel Corp. v. Continental Illinois National Bank & Trust Co.	167
Notes and Questions	170
4. Private Adjudication	172
Carbajal v. H&R Block Tax Services, Inc.	172
Notes and Questions	173
<b>Chapter IV Externalities</b>	
A. Externalities	175
1. Negative Externalities	176
Orchard View Farms, Inc. v. Martin Marietta Aluminum, Inc.	178
Notes and Questions	183
2. Positive Externalities	184
B. Dealing with Externalities	186
1. The Assignment and Enforcement of Property Rights	186
a. Bargaining and the Coase Theorem	187
Prah v. Maretti	188
Notes and Questions	194
b. Transaction Costs	195
Boomer v. Atlantic Cement Co., Inc.	197
Notes and Questions	201

Spur Industries, Inc. v. Del E. Webb Development Co.	202
Notes and Questions	206
2. Corrective Taxes and Subsidies	206
3. Government Regulation	208
a. Direct Regulation v. Corrective Taxes	209
b. Selling Rights to Pollute	209
C. Market Failures and Government Failures	211
Markets and the Environment: Friends or Foes?	211
Notes and Questions	218
<b>Chapter V Information Costs and Transaction Costs</b>	
A. Asymmetric Information and Market Responses	221
1. The Market for “Lemons”	221
2. Adverse Selection and Insurance Contracts	222
3. Reputational Bonds and Other Market Mechanisms for Disclosing Information About Quality	222
The Role of Market Forces in Assuring Contractual Performance	223
Notes and Questions	228
B. Monitoring Contractual Performance: Agent-Principal Contracting	230
C. Opportunism: Market and Contractual Solutions	233
1. Firm-Specific Investments and the Appropriation of Quasi-Rents	234
Lake River Corp. v. Carborundum Co.	235
Notes and Questions	239
2. Franchising	242
Corenswet, Inc. v. Amana Refrigeration, Inc.	243
Transaction Cost Determinants of “Unfair” Contractual Arrangements	247
Notes and Questions	252
D. Corporate Governance	255
1. Shareholder Voting and Rationally Ignorant Shareholders	256
2. Agency Costs and Owner/Manager Conflicts	257
3. The Contractual Theory of the Corporation	258
a. The Market for Corporate Control	259
Notes on the Market for Corporate Control	260
b. Product Market Competition	261
c. Capital Market Competition and Capital Structure	261
d. Corporate Performance and Executive Compensation	262
Kamin v. American Express Co.	263
Notes and Questions	265
e. Markets for Managers	266
f. The Board of Directors	267
g. Ownership Structure	267
h. Corporate Law and Fiduciary Duties	267
Jordan v. Duff and Phelps, Inc.	268
Notes and Questions	274
i. Corporate Federalism	276
Notes and Questions on Corporate Federalism	276
j. Enron, WorldCom, and the Sarbanes-Oxley Act of 2002	277

## CONTENTS

xi

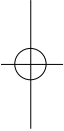
<b>Chapter VI Risk</b>	
A. Economics of Uncertainty and Risk	279
1. Basic Probability Theory	279
2. Expected Value and Variance	280
3. Expected Utility and Risk Preference	282
B. Insurance	286
1. Demand for Insurance	286
2. Supply of Insurance	286
a. Adverse Selection	287
Hall v. Continental Casualty Co.	287
Notes and Questions	290
b. Moral Hazard	290
Atwater Creamery Co. v. Western National Mutual Insurance Co.	291
Notes and Questions	294
c. Insurer's Duty to Settle	295
Mowry v. Badger State Mutual Casualty Co.	295
Notes and Questions	300
3. Self-Insurance	301
C. Risk and Market Prices	301
1. Financial Products	301
The Rights of Creditors of Affiliated Corporations	302
2. Products and Services: Risk Allocation and Contract Law	303
a. Assumption of Risk	304
Molinari v. Tuskegee University	304
Notes and Questions	306
b. The Bargaining Principle and Least-Cost Risk Avoider	307
c. The Allocation of Risk—Impracticability and Mistake	307
Eastern Air Lines v. Gulf Oil Corp.	307
Notes and Questions	309
Wilkin v. 1st Source Bank	310
Notes and Questions	312
3. Compensating Wage Differentials and Market Levels of Safety	313
4. Information, Risk, and Price Adjustments	315
D. Tort Law	315
1. Behavior Modification and Minimizing the Costs of Accidents	315
United States v. Carroll Towing Co.	316
Notes and Questions	318
2. Loss Spreading and Insurance	323
Greenman v. Yuba Power Products, Inc.	323
Notes and Questions	325
The Current Insurance Crisis and Modern Tort Law	327
Notes and Questions	334
3. Allocative Efficiency	336
Doe v. Miles Laboratories, Inc.	336
Notes and Questions	339
4. Tort Damages and Incentives	340
a. Compensatory Damages	340
O'Shea v. Riverway Towing Co.	340

b. Punitive Damages	340
Mathias v. Accor Economy Lodging, Inc.	341
Notes and Questions	345
c. Collateral Source Rule	347
Helfend v. Southern California Rapid Transit District	347
Notes and Questions	350
E. Risk Regulation	351
1. Cost-Benefit Analysis	351
UAW v. Occupational Safety & Health Administration	351
Notes and Questions	356
2. Measuring Risk: All Risks Are Relative	361
Corrosion Proof Fittings v. Environmental Protection Agency	361
Notes and Questions	367
3. Risk v. Risk	368
Competitive Enterprise Institute v. NHTSA	369
4. Risk Regulation Priorities	369
5. Political Economy of Health and Safety Regulation	370
<b>Chapter VII Competition and Monopoly</b>	
A. Costs of Production	374
1. Short-Run Production	374
a. The Law of Diminishing Marginal Returns	374
b. Short-Run Costs	376
2. Long-Run Production	379
a. Long-Run Costs	379
b. Economies, Diseconomies, and Minimum Efficient Scale	380
3. Changes in Costs of Production	382
4. Profits and the Costs of Production	383
B. The Competitive Market	384
1. Short-Run Individual Firm Behavior: Profit Maximization	384
2. Loss Minimization: The Shut-Down Decision	387
3. The Short-Run Supply Curve	388
4. Long-Run Firm Behavior: Industry Supply	388
5. The Economic Benefits of Competition	392
C. The Dynamic Competitive Process	393
1. Advertising	395
Bates v. State Bar of Arizona	395
Notes and Questions	402
2. Point of Sale Services	403
Continental T.V., Inc. v. GTE Sylvania, Inc.	403
Notes and Questions	411
D. Monopoly	413
1. Profit Maximizing Price and Quantity	413
2. The Social Costs of Monopoly	417
a. Deadweight Costs	417
b. Rent-Seeking Costs	419
c. Other Criticisms of Monopoly	420
3. Barriers to Entry	422
4. Collusion and Cartel Theory	422

## CONTENTS

xiii

5. The Quest for Monopoly Profits	424
a. Price Fixing	425
Goldfarb v. Virginia State Bar	425
Notes and Questions	429
b. Price Fixing and Intellectual Property Rights	431
Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.	431
Notes and Questions	441
c. Price Discrimination	442
d. Predatory Pricing	444
Matsushita Elec. Indus. Co. v. Zenith Radio Corp.	444
<b>Chapter VIII Principles of Valuation</b>	
A. Discounted Present Value	447
1. The Present Value Formula	448
2. Rules of Thumb for Determining Present Value	449
a. The Perpetuity Rule	451
b. The Rule of 72	451
B. Discounting and Litigation	451
1. Determining the Relevant Future Stream	452
Haugan v. Haugan	452
Notes and Questions	456
Diocese of Buffalo v. State of New York	456
Notes and Questions	459
2. Determining the Proper Interest Rate	460
Trevino v. United States	460
Notes and Questions	463
3. Pulling It All Together	465
O'Shea v. Riverway Towing Co.	465
Notes and Questions	469
C. The Value of Life	470
1. Economic Value of Life	470
Cappello v. Duncan Aircraft Sales of Florida	470
Notes and Questions	472
2. The Hedonic Value of Life	473
Mercado v. Ahmed	474
Notes and Questions	478
D. Valuation of Close Corporations	479
1. Discounted Future Returns Approach	481
Kleinwort Benson, Ltd. v. Silgan Corp.	481
Notes and Questions	485
2. Approaches Using Current or Historical Data	487
Central Trust Co. v. United States	490
Notes and Questions	497
Glossary of Economics Concepts	499
Index	519



## Table of Cases

---

- Alaska Packers' Association v. Domenico, 81–84
- Albrecht v. Herald, 411, 413
- Alleghany Corp. v. Kirby, 171
- Amanda Acquisition Corp. v. Universal Foods Corp., 276
- Atwater Creamery Co. v. Western National Mutual Insurance Co., 291–295
- Bates v. State Bar of Arizona, 395–402
- Boomer v. Atlantic Cement Co., Inc., 197–201, 204, 206
- Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 431–442
- Cappello v. Duncan Aircraft Sales of Florida, 470–472
- Carbajal v. H&R Block Tax Services, Inc., 172–173
- Central Trust Co. v. United States, 490–498
- City of Columbia v. Omni Outdoor Advertising, Inc., 131–135, 141
- Competitive Enterprise Institute v. National Highway Traffic Safety Admin., 88–91, 369, 470
- Continental T.V., Inc. v. GTE Sylvania, Inc., 232, 403–412
- Corenswet, Inc. v. Amana Refrigeration, Inc., 243–247, 252–253
- Corrosion Proof Fittings v. Environmental Protection Agency, 361–368
- Craigmiles v. Giles, 136–137
- Daubert v. Merrill Dow Pharmaceuticals, Inc., 45, 47–48, 49, 478
- Diocese of Buffalo v. State of New York, 456–459
- Doe v. Miles Laboratories, Inc., 336–339
- Eastern Air Lines v. Gulf Oil Corp., 307–309
- Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc., 133–136
- Eldred v. Ashcroft, 31–37
- Escola v. Coca Cola Bottling Co., 325–326
- Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc., 27–30, 191, 194
- Golden v. McCurry, 321–322
- Goldfarb v. Virginia State Bar, 398, 425–430
- Greenman v. Yuba Power Products, Inc., 323–325, 327, 328
- Hagemeyer North America, Inc. v. Gateway Data Sciences Corp., 159–163
- Hall v. Continental Casualty Co., 287–290
- Haugan v. Haugan, 452–456, 464
- Helfend v. Southern California Rapid Transit District, 347–350
- Henningsen v. Bloomfield Motors, 80–81
- Hickman v. Taylor, 158
- In Re Aluminum Phosphide Antitrust Litigation, 44–49
- In re Rhone-Poulenc Rorer, Inc., 166–167
- In re: Bridgestone/Firestone, Inc., 164–167
- Jones v. Star Credit Corp., 79–80, 99–101
- Jordan v. Duff and Phelps, Inc., 268–274
- Joy v. North, 274–275
- Kamilewicz v. Bank of Boston, 171
- Kamin v. American Express Co., 263–266
- Kleinwort Benson, Ltd. v. Silgan Corporation, 481–487
- Kohls v. Duthie, 152–156
- Lake River Corp. v. Carborundum Co., 235–239, 241
- Liggett Co. v. Lee, 276
- Lochner v. New York, 136
- M. Kraus & Bros., Inc. v. United States, 94–97
- Mars Steel Corp. v. Continental Illinois National Bank & Trust Co., 167–170
- Mathias v. Accor Economy Lodging, Inc., 341–344
- Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 11–15, 444–445
- Mercado v. Ahmed, 474–478
- Molinari v. Tuskegee University, 304–306
- Mowry v. Badger State Mutual Casualty Co., 295–300
- O'Shea v. Riverway Towing Co., 340, 465–470

<p><b>Orchard View Farms, Inc. v. Martin Marietta Aluminum, Inc.</b>, 178–184</p> <p><b>Page v. United States</b>, 39–41</p> <p><b>Pa rker v. Brown</b>, 132, 135, 396, 425–426, 428</p> <p><b>Peevyhouse v. Garland Coal &amp; Mining Co.</b>, 67–71</p> <p><b>Perkins v. F.I.E. Corp.</b>, 335</p> <p><b>Perma Life Mufflers, Inc. v. International Parts Corp.</b>, 253</p> <p><b>Power v. Harris</b>, 136–137</p> <p><b>Prah v. Marette</b>, 188–194</p> <p><b>ProCD, Inc. v. Zeidenberg</b>, 442–443</p> <p><b>Republican Party of Minnesota v. White</b>, 142–150</p> <p><b>Reynolds Metals Co. v. Lampert</b>, 179, 183–184</p> <p><b>Richman v. Charter Arms Corp.</b>, 335</p> <p><b>Schiller &amp; Schmidt, Inc. v. Nordisco Corp.</b>, 49</p> <p><b>Sedmak v. Charlie’s Chevrolet, Inc.</b>, 61–65</p> <p><b>Shepard v. Superior Court</b>, 326–327</p> <p><b>Sherwood v. Walker</b>, 311–312</p>	<p><b>Spur Industries, Inc. v. Del E. Webb Development Co.</b>, 202–206</p> <p><b>State Oil Co. v. Kahn</b>, 413</p> <p><b>Trevino v. United States</b>, 460–464</p> <p><b>UAW v. Occupational Safety &amp; Health Administration</b>, 351–360, 472–473</p> <p><b>United States v. Arnold, Schwinn &amp; Co.</b>, 403, 404–411, 412</p> <p><b>United States v. Carroll Towing Co.</b>, 316–318, 321, 353</p> <p><b>United States v. Miller</b>, 66</p> <p><b>United States v. Topco Associates Inc.</b>, 433, 441</p> <p><b>Weinberger v. UOP, Inc.</b>, 486</p> <p><b>West Lynn Creamery, Inc. v. Healy</b>, 137–140, 141</p> <p><b>Wilkin v. 1st Source Bank</b>, 310–312</p> <p><b>Williams v. Walker Thomas Furniture Co.</b>, 76–77</p> <p><b>Williams v. Walker Thomas Furniture Co. II</b>, 77–79, 80, 100, 253</p> <p><b>Wronski v. Sun Oil Co.</b>, 22–23</p> <p><b>Wyoming v. Oklahoma</b>, 141</p>
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# Preface to the Second Edition

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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.

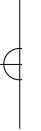
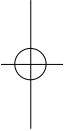
The remaining chapters may be covered in whatever order the instructor prefers. As with the first edition, the organization is by economic concept rather than by substantive legal area. Chapter 4 discusses externalities and legal responses to externalities. Chapter 5 combines two chapters from the first 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

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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