

Two Page Examination

Department of Economics

George Mason University

Law and Economics Field Examination

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Answer FIVE Questions

Each question is equally weighted

1 Consider the following contractual situation: A buyer B contracts to purchase in the future a good from a seller S. Both parties are risk neutral. The seller's production cost, C , is uncertain and will be determined after the contract is signed but before the good is delivered. Its expected value is $E(C)$. The price of the good, P , is set when the contract is signed but is payable only upon delivery. The value of the good to the buyer is $V(r)$, where r is the buyer's dollar investment in transaction-specific capital or reliance. $V' > 0$. In the event of non-performance $V(r) = 0$. If the seller decides to breach, the buyer files suit at zero cost and the court awards damages, $D \geq 0$, which may be a function of r and P :

- (a) If $D = 0$, under what conditions will the seller breach his contract?
- (b) Using formal analysis, derive the socially optimal solution in terms of the optimal reliance decision by the buyer and the optimal breach decision by the seller.
- (c) Will expectation damages achieve an efficient outcome?
- (d) Will reliance damages achieve an efficient outcome?
- (e) Will restitution damages achieve an efficient outcome?
- (f) What happens if one or both parties is risk-averse?
- (g) Should courts always enforce liquidated damages clauses?

2. 'Since there are occasions when every vessel will break from her moorings, and since, if she does, she becomes a menace to those about her, the owner's duty, as in other similar situations, to provide against resulting injuries is a function of three variables: (1) the probability that she will break away; (2) the gravity of the resulting injury, if she does; (3) the burden of adequate precautions. Possibly it serves to bring this notion into relief to state it in algebraic terms: If the probability be called P ; the injury L ; and the

burden B; liability depends upon whether B is less than L multiplied by P; i.e. whether $B < PL$. (Judge Learned Hand, *United States v. Carroll Towing Co.* 1947:

(a) Are any adjustments necessary to make the Hand Formula conform to the economic model of due care. Be as explicit as possible in your answer and illustrate with numerical examples. Restrict your answer here to cases of alternative care.

(b) How relevant is the Hand formula as he stated it for cases of joint care? How should the formula be adapted to conform to the economic model of due care under joint care circumstances?

(c) To what extent do contemporary United States courts rely upon the Hand Formula in dealing with accident cases? Illustrate your answer by reference to important accident cases.

3 'The central challenge facing those who want to know how legal rules affect behavior is understanding how to craft legal rules in a world in which information is incomplete' (Baird, Gertner and Picker 1994):

To what extent is game theory helpful in such circumstances? Illustrate your answer using specific game theory examples with respect to accident law.

4. Define the concept of "optimal deterrence" and evaluate it with respect to (1) tortious accidents and (2) criminal activities. Use economic analysis to provide simple guidance to lawmakers and judges who wish to apply this concept to regulating and deciding cases. In what ways are penalties in the law of tort and criminal law equivalent to prices in economic theory? Are there any reasons why this equivalence may not hold in practice?

5. Evaluate the effects of criminal background checks on the employment opportunities of black males. Assume that black males are more likely to have been imprisoned in the past than other males. In your discussion, you may wish to take into account the wages and skills of black males and to make and analyze various other assumptions to develop your argument.

6. Discuss the advantages and disadvantages of relying primarily on statutory law (legislation) rather than on the common law in efficiently controlling the so-called taking of private property through government regulation. Illustrate your answer with specific examples of regulatory takings.