

Chapter 24 #1: Define: default rule and exculpatory clause. Provide some examples.

A default rule is a legal ruling that takes place when there is no statement that indicates to the contrary. Exculpatory clauses are examples of these contrary statements. For example, in the absence of an agreement to the contrary, laundries might be liable for clothes left over thirty days. This is the default rule. By posting a notice that they will not be responsible for clothes left over thirty days, laundries can overrule the unstated expectations. This is the exculpatory clause.

Chapter 24 #2: When the exculpatory clauses are allowed, why are courts virtually incapable of affecting either the distribution of wealth or the outcome?

If exculpatory clauses are allowed, the final assignment of liability does not depend on the initial allocation of liability, which the courts could have determined.

Chapter 24#3: Compare a legal regime that says that the producer is strictly liable for actual damage to the consumer to a regime that says that the producer is not at all liable for damage to the consumer. Compare levels of safety under the two regimes; also discuss who pays for insurance. Assume that the consumer's behavior has no effect on the probability of damage (e.g., a Coke bottle).

(A) Assume that exculpatory clauses are allowed and consumers and producers are perfectly informed about all risks.

If the producer is strictly liable for actual damage and it is cheaper for the consumer to insure than pay the expected cost of damage, then the producer will include an exculpatory clause and the consumer will purchase insurance. However, if it is cheaper for the producer to sell a safer good than buy insurance, then he will end up just selling a safer good and charging a higher price. Lastly, if it is the cheapest for the producer to purchase insurance instead of producing a safer good or having the consumer purchase insurance, the producer will just purchase insurance and then charge the consumer extra.

However, if the producer is not at all liable, then if he can make some profit by producing a safer good and charging a premium lower than the insurance rate that the buyer can purchase, then he will do so. If the producer finds that producing a safer good is more expensive than the insurance rate he has to pay, he will purchase insurance and charge extra on the product. He will then incorporate an exculpatory clause saying that he is liable for the damages. Lastly, if the producer's rates and cost of producing the safer good is higher than the insurance rate that the buyer has to pay, then the producer will sell the good at the original price and then the buyer will just have to purchase the insurance.

(B) Assume that exculpatory clauses are not allowed, that consumers and producers are perfectly informed about all risks, and that one side is able to obtain insurance at the actuarially fair rate but the other cannot.

Under strict liability, the producer will compare the cost of making a safer set of goods and the insurance rates he has to pay. If the cost is higher than insurance rates, then the producer will

simply purchase insurance. If the cost is lower than insurance rates, then the producer will produce the safer goods.

Chapter 24#5: In *Helling v. Carey*, 519 P.2d 981 (1974), the court found ophthalmologist Carey liable for Helling's undiagnosed and therefore untreated glaucoma. Defendant Carey testified that the standard for the profession was to not test for glaucoma for people under 40 years old, as the incidence for this age group was 1 in 25,000. Helling was 32 at the time of her visit. Suppose the harm to people under the age of 40 when they have glaucoma and are not treated is \$1 million. Suppose further that the cost of the test is \$20. Who should be liable under these assumptions?

*Given that the expected of cost Glaucoma is $\frac{1}{25000} * \$1,000,000 = \40 , we see that this is higher than the cost of the test. Therefore, it would have been much cheaper for Helling to schedule and take a test, herself.*