Contract Law & Economics

Dr. Ann-Sophie Vandenberghe

Lecturer: Dr. A.-S. Vandenberghe
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Content
Contract drafting requires much more than knowing the legal boundaries within which parties have to operate. Lawyers (and economists) also need an in-depth understanding of the functions of contract types and clauses. This course analyzes contracts in terms of costs, incentives, risks and transaction costs. It also discusses strategic aspects, such as the (re)negotiation position before and during the contract, and the signing-without-reading problem. General issues include: the optimal level of detail and third-party governance in contracts; the optimal amount of pressure on obligations; the optimal allocation of commercial and other risks; the optimal timing of performance and payment; self-enforcing contracts; and general techniques to incentivize monitors and hard-to-monitor promisors. Applications include franchise contracts, lease contracts, lawyer-client contracts, contractual arrangements in agriculture, royalty contracts, contracts in the entertainment industry, oil production contracts, penalty clauses warranty clauses, forum clauses, futures, severance pay, termination clauses, covenants not to compete, automatic renewal clauses, warranties, and the duty to inform.

Learning objectives
After the course the student is able to:
• give legal advice or do consultancy services to contract choice and contract design;
• do scientific research on the intersection of Economics and Law.
• apply legal and economic contract theories and practices interchangeably;

Format
Lectures with class discussion of applications and assignments. Students are required to be prepared for active class discussions by completing all reading assignments and writing assignments, and by actively participating in oral discussions.

Assessment method/Examination
Students performance is tested by means of his/her performance on a final examination (80 % of the final grade) and on written assignments during the course (20 % of the final grade)
• Final written test: written exam at the end of the course, closed book (80 % of the final grade).
• Written assignments during the course (20% of the final grade). Assignments should be made individually at home and handed in before class (by sending them to management@emle.org), according to the schedule below (see program). The assignments can be found below (see assignments).

Exam material:
Course material, class content and class discussion notes, slides and other material made available.
Course material

- Course materials and lecture slides distributed during or after each lecture
- Working papers, articles and chapters, all freely downloadable:
  
  
  
  
  
  
  
  
  
## Program: Schematically, theme of the lectures, reading and written assignments.

<table>
<thead>
<tr>
<th>Date</th>
<th>Theme</th>
<th>Task</th>
<th>Format/Assessment</th>
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</thead>
<tbody>
<tr>
<td>Whole course</td>
<td>Contract law and economics</td>
<td>Read Hermalin, Katz and Craswell (2006); Shavell (2003); Cooter and Ulen (6th ed. Chapters 8 and 9)</td>
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<tr>
<td>2) 13 Feb.</td>
<td>Techniques to solve incentive problems in contracts.</td>
<td>Read De Geest, N Problems Require N Instruments (2012). Prepare: assignments 1(unfair terms) and 2 (contract breach)</td>
<td>Lecture with class discussions of assignments</td>
</tr>
<tr>
<td>4) 22 Feb</td>
<td>Risk allocation. Commercial risks</td>
<td>Prepare assignment 3 (inc, risk, TAC analysis).</td>
<td>Lecture with class discussion of assignment</td>
</tr>
<tr>
<td>5) 27 Feb.</td>
<td>Monopoly situations. Duress, necessity and related doctrines</td>
<td>Prepare assignment 4 (futures)</td>
<td>Lecture with class discussion of assignment</td>
</tr>
<tr>
<td>7) 6 Mar.</td>
<td>Long-term contracts</td>
<td>Prepare assignment 6 (24-year beer tie).</td>
<td>Lecture with class discussion of assignment</td>
</tr>
<tr>
<td>8) 7 Mar.</td>
<td>Employment contracts</td>
<td>Read Vandenberghe (2009); Prepare assignment 7 (seniority rule)</td>
<td>Lecture with class discussion of assignment</td>
</tr>
<tr>
<td>11/12) 15 Mar</td>
<td>Final conclusions</td>
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<td>Lecture and questions</td>
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<tr>
<td>20 Mar</td>
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<td></td>
<td>Final Exam (written test)</td>
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### Course outline

**Lecture 1 – Introduction.**


**Lectures 2 – General incentivizing techniques**

Topics: Opportunistic breach of contract. General solutions to a Prisoners’ dilemma. Opportunistic renegotiation of contracts. Relationship-specific investments. Optimal sanctions for contract breach (how much pressure should be put on obligations)? Informal Strategies (how to solve incentive problems in the absence of a binding contract).
Applications.

**Lecture 3: General incentivizing techniques**


**Lecture 4 – Risk Analysis. Commercial risk allocation. Techniques to prevent involuntary commercial risk taking. Incentivizing entrepreneurs.**


**Lecture 5 – Monopoly situations, duress, and related doctrines**

**Topics:** Contract renegotiation. Limits of freedom to contract. Applications.

**Lecture 6 – Precontractual negotiations – information exchange**


**Lecture 7 – Transaction cost analysis. Incomplete and long-term contracts**


**Lecture 8 – Employment contracts**


**Lectures 9 and 10 – Consumer contracts**

**Topics:** Right to withdraw. Automatic renewal clauses. Warranty clauses. Privacy.

**Lectures 11 and 12 – final conclusions – synthesis - applications**
Assignments:

1. Regulation of unfair terms in consumer contracts

to a large extent harmonized the rules on unfair contract terms in the member states of the Eu-
ropean Union.

(1) Is this directive compatible with Law & Economics theory on signing-without-reading
problems?
(2) Comment on the following article:
Article 3 (3): “The Annex shall contain an indicative and non-exhaustive list of the terms
which may be regarded as unfair.” The annex lists “Terms which have the object or effect
of:” (e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately
high sum in compensation;

2. Contract breach: ordering a boat at six dealers.

Mr. Waters placed orders for delivery of a boat at six different dealers. When the first boat
comes in, he immediately cancels the other orders. Should he be able to cancel without penal-
ty, or should the law discipline such breachers? And what is the best sanction? (damages?
specific performance? a criminal sanction?)

3. Incentives, risks and transactions costs

Contractual arrangements in agriculture:

In pre-industrial times, different contractual arrangements in agriculture existed. (1) the fixed
rent contract, (2) sharecropping or (3) the fixed wage contract. Under the fixed rent contract,
the farmer paid a fixed rent to the landowner. Under sharecropping, the farmer and the land-
owner share the harvested crops (e.g. each gets 50 %). Under the fixed wage contract, the
landowner hires workers to do farm work and pays them a fixed wage.
Compare the incentives, transaction costs and risks under the different contractual arrange-
ments.

Lawyer-client contracts:

Different contractual arrangements between a lawyer and his client exist. (1) the fixed fee
contract, (2) the hourly fee contract or (3) the contingency fee contract.
Compare the incentives, transaction costs and risks under the different contractual arrange-
ments.

California gold-rush:

Two general types of contracts were used in the California gold-mining rush of the 19th centu-
ry: (1) the sharing contract and (2) the land allotment contract
Under the sharing contract, each miner in the group agreed to work a certain number of hours
per day. At the end of the day, all the gold collected by the members was deposited into a
common pool. It was then measured and divided among the members of the group according
to a specific formula, usually an equal share for each member. Under the land allotment con-
tract, each individual in the group was assigned a separate parcel of land within the mining
district. Each miner got to keep all the gold he extracted from his own parcel.
Compare both types of contracts in terms of a) incentives created b) transaction costs and c)
risk allocation.
4. Futures

A grower of carrots has a contract to deliver his entire output to a large soup company. There is a tremendous shortage of this type of carrot and the market price rises to three times the contract price. The grower threatens to breach unless the soup company agrees to a modification. The company does so because it believes that if it does not get these carrots it would have to close down some of its production lines for the entire canning season and that it would not be able to recover these damages if it refused to negotiate and later sued the grower for breach. After the season is over, the soup company sues for the difference between the prices in the original and modified contracts. It argues that there was no consideration for the second promise and that the modified contract was signed under conditions of duress.

(a) How should its claim be resolved?
(b) Should there be a duty to negotiate? Or should it be forbidden to (re)negotiate the contract terms (renegotiation proof contract)?
(c) What should be the sanction for contract breach?

5. Duty to disclose

Professor Schmidt, a geologist, has agreed to purchase McDonald's farm for a price of $2,000 per acre, which corresponds to the price of good quality farmland in the vicinity. However, Schmidt, on the basis of his own geological studies, is convinced that McDonald's farm contains valuable mineral deposits, which make the property worth $25,000 per acre. Schmidt's true motive is discovered by McDonald before he takes possession, and McDonald refuses to hand over the property. Schmidt sues for breach of contract. McDonald defends on the ground that Schmidt had a duty to disclose the results of his studies. According to economic analysis, who should win? Explain why.

6. The 24-year Beer Tie

(Excerpt from Beale, Hugh, Hartkamp, Arthur, Kötz, Hein, and Tallon, Dennis (2002), Cases, Materials and Text on Contract Law, Hart Publishing, p. 313-314) “Facts: The defendants, owners of a restaurant, had agreed in 1954 to buy all their requirements of beer and non-alcoholic beverages exclusively from the plaintiff, a brewery, for a period of twenty-four years ending on 31 October 1978. The defendants terminated the agreement on 31 October 1964, i.e. after ten years. The plaintiff brought an action against the defendants relying on a clause in the contract providing that in the event of a termination prior to 31 October 1978 the defendants were to pay a penalty of 15% of the amount they would have paid for purchases of beer and non-alcoholic beverages during the remainder of the agreed contract period.”

“Held: The Bundesgerichtshof held that the penalty should be assessed for the period that would have been justified (a sixteen-year tie would have been reasonable, a twenty-four year tie was considered to be contrary to public policy).”

Note. In the 1950s and 1960s, it was very common in Germany and Belgium to let a brewer finance a part of the cafe or bar. In return, the cafe owner had to promise to buy all drinks (at that time mainly beer and water) from that brewer during a long period. In the 1960s and 1970s these contract came under pressure, because customers started to demand wine and products like Coca-Cola (local brewers started to make their own cola, but customers generally believed that their taste was not as good as the real one).

Questions:
(a) Analyze: ex post opportunism by the brewer (compare to opportunism by a franchisor), risk allocation (unintended risk creation?), efficient breaching decisions by the restaurant and cafe owner.
(b) In these contracts, brewers delivered both beer and capital. Is it not unlikely that the same company will be the best choice for both beer and capital? Can this type of tying contractual arrangements ever make economic sense? Should not those bundling contracts be forbidden from the start? Or can they make sense in some cases?
(c) What would you have decided if you would have been the judge?

7. Seniority rule

According to the seniority rule, the longer you work at a place, the higher you get paid. Since the true productivity is not always directly related to the wage received (most people are more productive when they are 35-40 than what they are 60-65), this actually means that people are underpaid when they are 30 and overpaid when they are 55.
The seniority rule is used by most bureaucracies, by most European universities, by some big firms, and by some law firms.
(a) Discuss all the incentive problems that are solved as well as created by the seniority rule.
(b) If a seniority system is used, should it be possible for each of the parties to terminate the contract at will? Or only on a just cause basis?
(c) Describe very precisely under what conditions this contractual arrangement can make sense.

8. Automatic renewal clauses

Many consumer subscription contracts contain an automatic renewal clause. According to this clause the contract is automatically renewed for a new period of time unless it is cancelled. As it turns out many consumers forget to cancel in due time in which case they are bound for a new term.

Would rational parties ever agree to include such a clause in the contract? Or should regulators forbid such a clause?
Empirical Legal Studies

Rotterdam, Term 2

Version 1.0 (January 10, 2017).

Instructor: Jonathan Klick & Jaroslaw Kantorowicz
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        j.j.kantorowicz@fgga.leidenuniv.nl
**Schedule**

**Lectures**

**Lecture 1. Descriptive Statistics and intro to STATA** (January 19)
- Mandatory reading: OpenIntro Statistics (pp. 9-14, 26-42, 127-137).

**Lecture 2. Formulating Hypotheses** (January 23)

**Lecture 3. Inference** (January 24)
- Mandatory reading: OpenIntro Statistics (chapter 4 & 5 without special topics).

**Lecture 4. Regression** (January 25)
- Mandatory reading: OpenIntro Statistics (chapter 7)

**Lecture 5. Correlation vs. causation** (January 26)
- Mandatory reading: Gelbach & Klick (2014).

**Lecture 6. Causal inference** (January 27)
- Mandatory reading: Gelbach & Klick (2014).
Lecture 7. Panel data (February 27)

Lecture 8. Regression discontinuity (February 28)
   Mandatory reading: MacDonald et al. (2016).

Lecture 9. Event studies (March 1)

Lecture 10. Empirical Work in Litigation (March 2)

Lecture 11. TBD (March 3)

Tutorials

Tutorial 1. Descriptive statistics (February 2)

Tutorial 2. Regression (February 9)

Tutorial 3. Panel data (February 28)

Tutorial 4. Regression discontinuity (March 14)

Tutorial 5. Event studies (March 16)
LITERATURE

Mandatory readings


Further readings


SOFTWARE

This course will use STATA as a primary statistical package in the applied sessions. Free resources to help you learn and use STATA are available here. STATA Learner videos can be accessed here and visual overview for creating graphs here. More STATA Tutorials: (1) Princeton, (2) UNC.
Corporate Law & Economics

Patrick C. Leyens

Syllabus

Class 1: Transaction governance and corporations ........................................ 2
Class 2: Corporations and the law ................................................................... 2
Class 3: Corporate governance ......................................................................... 2
Class 4: Control transactions ........................................................................... 3
Class 5: Regulatory challenges (incl. revision) ............................................... 3
Bibliography .................................................................................................... 4

Summary

“Corporate Law & Economics” is an advanced EMLE course. As a 2nd term course it seeks
to enable students to follow and contribute to the state to the art discussions in law &
economics. Corporations are taken as an example for illustrating an L&E view of
transaction governance. The course aims to enhance the understanding of the interaction
between markets, contracts and corporations. Fields of the law treated are corporate and
capital market law, including references to contract law.

The course covers questions such as: (1) When is a corporation a functional transaction
structure? (2) For which of the core structural elements of corporations is law needed? (3)
Which corporate governance problems does the law have to solve? (4) To what extent do
specific problems of control transactions interact with corporate governance? (5) In view of
one to four, which are the challenges a functional rule making take should care of?

Course readings are taken mainly from the ‘Anatomy of Corporate Law’, edited by
Kraakman et al., 2nd ed., 2009. Selected chapters of the ‘Anatomy’, additional readings and
further materials are available online. Parts of the last class will be devoted to a training
session exclusively dealing with possible answers to exam questions.
Class 1-2: Transaction governance and corporations

Summary: course aim, the firm and its size, transaction governance, governance and costs, incomplete contracts, hold ups, modes of governance.

Main question: When is a corporation a functional transaction structure?

Topics:
- Coase’s world: transaction costs
- Klein’s world: hold-ups
- Williamson’s world: critical dimensions

Readings
- Coase, 4 Economica 386 (1937)
- Klein, 4 J. L. Econ. & Organ. 199 (1988), esp. p. 199-208
- Williamson, 22 J. L. Econ. 233 (1979)

Class 3-4: Corporations and the law

Summary: characteristic elements of corporations (large business enterprises), evolution and role of corporate law, market failure, information asymmetry, moral hazard.

Main Question: For which of the core structural elements of corporations is law needed?

Topics:
- What is a corporation?
- What is corporate law?
- What drives corporate law?
- Outlook: how to analyse agency problems?

Obligatory reading:
- Anatomy, p. 1-34.

Voluntary readings:

Class 5-6: Corporate governance

Summary: agency costs, regulatory and governance strategies to reduce agency costs, incompatibilities b/w shareholder and management incentives, compliance enforcement strategies, board models.

Main question: Which corporate governance problems does the law have to solve?
Topics:
- How to reduce agency costs?
- How to enforce compliance?
- Why do managers not comply?
- What is the role of the board of directors?

Obligatory readings:
- Anatomy, 35- 87 (focus on 35-50, 55-78)

Voluntary readings:

Class 7-8: Control transactions

Summary: agency problems, market-based corporate governance, interdependence between internal and external corporate governance.

Main question: To what extent do specific problems of control transactions interact with corporate governance?

Topics:
- What are the core agency problems in takeovers?
- How does EU law address agency problems (as opposed to the U.S.)?
- When are takeovers functional for corporate governance?
- What do takeovers tell about modes of regulation?

Readings:
- Anatomy, 225-256, (267-273)

Voluntary readings:
- Easterbrook/Fishel, 94 Harvard L. Rev. 1161 (1981)

Class 9-11: Regulatory challenges (incl. revision)

Summary: These classes will be devoted to open questions and tailored to the progress made so far. General issues concern regulatory modes, path dependence and institutional capacities as well as our joint reflexion on future challenges.

Main question: In view of the foregoing classes, which are the challenges corporate law making should take care of?
Topics:
• What are the chances of new modes of regulation (esp. comply or explain)?
• Why is corporate law path-dependent (esp. privatisation failures in Russia)?
• What next in corporate law (esp. core assumptions in economic theory)?

Obligatory readings:
– Anatomy, 305-317
– T.b.a.

Voluntary readings:

Bibliography

a) Internet Resources
• Berlin Center of Corporate Governance (BCCG): http://www.bccg.tu-berlin.de.
• Corporate Governance Network: http://www.CorpGov.net.
• European Commission (Single Market), Information on state of company and capital market law in the EU, http://ec.europa.eu/internal_market/index_en.htm
• European Corporate Governance Institute, Corporate governance codes, corporate governance research (law paper series, finance paper series), http://www.ecgi.org
• Journal Storage (JSTOR), large database, mainly on economics, many original texts, http://www.jstor.org
• Max Planck Institute for Comparative and International Private Law, Bibliographical links to foreign and international law, legal history and library catalogues, http://www.mpipriv.de/ww/en/pub/library/research_tools/bibliographical_links.htm
• Social Science Research Network, largest international research database http://www.ssrn.com

b) General monographs and edited volumes
  *Note: This volume includes a comprehensive L&E Glossary.
• Towfigh/Petersen (eds.), Economic Methods for Lawyers, Cheltenham 2015.
c) Corporate Law

Selection of leading works on corporate governance for further purposes of research (important papers highlighted); for comprehensive compilations see Leyens, in: Hopt/Wiedemann (eds.), Kommentierung zu § 161 AktG, Berlin 2012, and same in: Hommelhoff et al. (eds.), Handbuch Corporate Governance, 2nd ed., 2009 –

- \textit{Bainbridge, Stephen M.}, Corporate governance after the financial crisis, Oxford 2012.
• same/Leyens, Patrick C., Board Models in Europe, ECFR 2004, 135.
• same/Wymeersch, Eddy/Kanda, Hideki/Baum, Harald, ed., Corporate Governance in Context, Oxford 2005.
• Jensen, Michael C./Meckling, William H., Theory of the firm, 3 J. Fin. Econ. 305 (1976).
• Kordel, Guido, Behavioral Corporate Governance from a Regulatory Perspective, 9 EBOR 29 (2008).
• La Porta, Rafael/Lopez-de-Silanes, Florencio/Shleifer, Andrei/Vishny, Robert W., Law and Finance, 106 J. Polit. Econ. 1113 (1998).
• same, German Company Law: Recent Developments and Future Challenges, 6 German L. J. 1407 (2005), <online>.
• Roe, Mark J., Political Determinants of Corporate Governance, Oxford 2003.
• Tirole, Jean, Corporate Governance, 69 Econometrica 1 (2001).
• Venturuzzo, Marco et al., Comparative Corporate Law, St. Paul 2015.
• Williamson, Oliver E., Corporate Finance and Corporate Governance, 43 J. Fin. 567 (1988).
Property Law and Economics – Judge Kerkmeester

Lecture 1 The Concept of Property Rights

Lecture 2 Property Rights and the Theory of the Firm

Lecture 3 Commons and Anti-Commons

Lecture 4 The Relations Between Neighbours; I: Bargaining in the Shadow of the Law

Lecture 5 The Relations Between Neighbours; II: Order Without Law

Lecture 6 Externalities and Entitlements

Lecture 7 Original Assignment of Private Property

Lecture 8 Possession and Limitation Statutes

Lecture 9 Zoning Law
- Literature to be announced

Lecture 10 Auctions of Rights in Public Property

Lecture 11 Property Rights in the Electromagnetic Spectrum

Lecture 12 Sample exam
- Exam 2016
1. There will be 5 sessions in this course, in each of them one case to be discussed by two teams (plaintiffs / defendants).

2. Each team has 5 or 6 members, as is shown in the table below. You have to contact your colleagues in your team in time to prepare for your sessions. For this, please read the overview table below. The division of students per group is decided by us and cannot be changed/discussed.

3. Each student will be in a team in two sessions: to prepare the case and to give a presentation in the specific session; all individual team members have to present a part of the presentation.

4. In the three sessions in which you do not have a specific role (= not presenting as being a member of one of the teams), you are expected to be familiar with the case materials and to participate in the class discussions as much as possible. Your involvement in the sessions where you do not have to present will help you write a better essay. Do not forget that attendance is anyway mandatory.

5. For this course, we will NOT have an exam at the university. The final mark for this course will be:
   - 50% for the presentation in class (including, eventually, any written paper to be submitted; this might be different per session), for those two sessions in which you have a specific role as a team member;
   - 50% for writing a short (individual) essay (max length 1000 words) for every session in which you do not present. The essays have to be handed in within two weeks after the session (to be sent by email to: management@emle.org. The total of these three (individual) essays will count as your (take-home) exam (to be graded).
   - Name your file [EMLE_ID]_Courts_1(2, 3, 4, 5).docx
   - Do not write your name on the essay or in the file name.

6. The study materials will be available – per session – on Google Drive around 1 week in advance of the specific session. At Google Drive, Rotterdam 2nd term – L&E in the Courts – per session.

7. More specific instructions per session will be in the materials per Session / Case on Google Drive.

<table>
<thead>
<tr>
<th>Date, time &amp; classroom</th>
<th>Case &amp; lecturer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Friday 27 January 2017 / 09.00 – 11.45 (Y1-20)</td>
<td>Case 1 – Visscher</td>
</tr>
<tr>
<td>Friday 3 February 2017 / 09.00 – 11.45 (Y3-09)</td>
<td>Case 2 – Pacces</td>
</tr>
<tr>
<td>Tuesday 21 February 2017 / 10.00 – 12.45 (T3-13)</td>
<td>Case 3 – Kovac</td>
</tr>
<tr>
<td>Monday 13 March 2017 / 13.00 – 15.45 (Y1-17)</td>
<td>Case 4 – Camesasca</td>
</tr>
<tr>
<td>Friday 17 March 2017 / 09.00 – 11.45 (tba)</td>
<td>Case 5 – Keske</td>
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</tbody>
</table>

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<thead>
<tr>
<th>Case</th>
<th>Topic</th>
<th>Lecturer</th>
<th>Roles to be played (number student)</th>
</tr>
</thead>
</table>
| 1    | Product liability: the Halcion case                                   | Vischer  | Team 1 (1-5): the attorney of the plaintiffs  
                                                   Team 2 (6-10): the attorney of the defendant |
| 2    | Liability of Corporate Directors                                      | Pacces   | Team 1 (1-5): the attorney of the plaintiffs  
                                                   Team 2 (6-11): the attorney of the defendant |
| 3    | Unforeseen contingencies, impossibility and excessively onerous performance: The Alcoa Case. | Kovac    | Team 1 (1-5): the attorney of the plaintiffs  
                                                   Team 2 (6-10): the attorney of the defendant |
| 4    | Multilateral Interchange Fees                                         | Camesasca/Janutta | Team 1 (1-5): the attorney of the plaintiff  
                                                   Team 2 (6-11): the attorney of the defendant |
| 5    | “Bureaucratia”                                                        | Keske    | Team 1 (1-5): the attorney of the plaintiff  
                                                   Team 2 (6-10): the attorney of the defendant |