Stockholm University

Department of Economics

Course name:	**Law & Economics 1**
Course code:	**EC2105**
Type of exam:	**Retake exam**
Examiner:	**Lars Vahtrik**
Number of credits:	**7,5 credits**
Date of exam:	**Sunday 31 March 2019**
Examination time:	**3 hours (12:00- 15.00)**

Write your identification number on each answer sheet (the number stated in the upper right hand corner on your exam cover).

Start each new question on a new answer sheet.

Explain notions/concepts and symbols. If you think that a question is vaguely formulated, specify the conditions used for solving it. Only legible exams will be marked.
No aids are allowed.

The exam consists of 4 questions. Each question is worth 25 points, 100 points in total. For the grade E 45 points are required, for D 50 points, C 60 points, B 75 points and A 90 points.

Question 4 is a credit question. If you have handed in assignments during the course you may choose to answer this question anyway if you aim at a higher score. Note that in this case only the score on the exam will be counted regardless of your score on the assignments!

Your results will be made available on your Ladok account **(**www.student.ladok.se)
within 15 working days from the date of the examination.

Good luck!

Question 1

a) In a professional car race on the Swedish forest roads a driver takes a turn too fast and unfortunately crashes into a group of people watching the race. Several people are badly injured. Please discuss who, if anyone, should be liable to pay damages for injuries suffered. **(10p)**

b) After the race, the organisation that arranged the race entered into bankruptcy. Please discuss different methods to ensure that potential injurers internalize the effects of a bankruptcy. (**10p)**

c) One of the spectators sued for damages in an amount less than SEK 20,000. In Sweden a dispute concerning such a small amount would be handled in a simplified procedure. Please discuss the concept of simplified legal proceedings and the pros and cons of this concept. **(5p)**

Question 2

The notorious criminal JACK contemplates robbing a drugstore. He knows that there are drugs worth 1200 $ in the store. The street market value of these drugs amounts to 1000$. To break into the drugstore JACK needs to break a door with a value of 200$. There is only one person, the owner, working in the drugstore and the store does not have an alarm so the probability that JACK will be caught by the police and get arrested is quite low, p = 0,20.

a) How much should JACK pay in damages to perfectly compensate the drugstore owner? Discuss why perfect compensation may not be possible in criminal suits in general. **(5p)**

b) Assume that JACK is risk neutral. Define and state the sum of perfect disgorgement. How large does a fine have to be to deter JACK from committing the robbery given that he is required to return the money he got from selling the drugs if he is caught? Alternatively assume that JACK is required to perfectly compensate the drugstore owner if he is caught and then recalculate the fine needed to deter JACK. **(7p)**

c) Discuss how JACK' s incentive to commit robbery changes with less resources allocated to the police, reducing the probability of being arrested (p), and a higher fine (f) given that expected cost of commiting the crime is unchanged? Will your answer be different if we assume that JACK is risk averse? (**7p)**

d) The drugstore owner contemplates installing a burglar alarm. She can either buy a clearly visible and loud alarm or a hidden silent alarm. Discuss if it is socially efficient to make the owner' s investment in a burglar alarm tax deductible in these two separate cases. **(6p)**

Question 3

Consider Hart and More's example with the chef, the skipper and the tycoon. Explain the setup in the example and discuss the consequences of different allocations of ownership of the yacht for the incentives to make relation specific investments that increase the value of the cruise. **(25p)**

Question 4 (Credit Question)

Consider an investor and an entrepreneur that can enter a business relationship where the investor invests 100 and where the joint profit of the investment amounts to 50 each in case the entrepreneur performs. In case the entrepreneur breaches the contract the investor gets -100 and the entrepreneur gets 100 (without damages). In addition our investor can make an additional investment with a third party of 90. If the entrepreneur performs our investor will increase the profit from 50 to 60 by making the extra investment and our entrepreneur still recieves 50. In case of breach the extra investment yields a payoff of -190 to the investor and 100 to the entrepreneur (without a contract). Will naïve expectation damages give the investor optimal incentives to invest in reliance? Explain and show, with the help of relevant calculations, how a correct interpretation of perfect expectation damages can solve the problem of optimal reliance in this case. **(25p)**