Chapter 6
Some Thoughts on Economic Reasoning in Appellate Courts and Legal Scholarship

With Norwegian Illustrations in Three Legal Dimensions

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Abstract Economists find it worthwhile to study the effects of law, and to offer explanations or recommendations in light of such studies. Lawyers also contribute to this same enterprise, i.e., using the intellectual tools typically developed and used by economists. A lawyer may do this because it has intrinsic (intellectual) value or because it is relevant, by which I mean that it is proper from the perspective of legal methodology (and, if applicable, his or her's own preferences). In this chapter, examples from Norway of such relevance are offered based on personal experienced as a judge and as a legal scholar. First, the intrinsic ingredient of economics in law is suggested using three appellate court cases that I co-decided for illustrative purposes. Secondly, three Norwegian contributions to legal scholarship are discussed to shed light on a demarcation problem that may arise more often in Europe than many other places and also to suggest more could and should be done to fuse economic analysis of law and doctrinalism. Thirdly, and relatedly, three principles for bridging economic reason and legal argument are highlighted. Although the main goal is to reflect normatively and exploratory on professional norms from the standpoint of someone who has internalized these norms, the chapter simultaneously reports "field data" contradicting Posner's claim that economic analysis of law is congenial to American judges only (Posner, *Legal Theory*, p. 42) and Eidenmüller's claim that it is a prerogative for the Legislator to take economic analysis of law into account (Eidenmüller, p. 490).

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K. Mathis (ed.), *Law and Economics in Europe: Foundations and Applications*,
Economic Analysis of Law in European Legal Scholarship 1,
DOI 10.1007/978-94-007-7110-9_6,

6.1 Introduction

6.1.1 Economic Reasoning

Economics is sometimes defined with emphasis on subject matter (money, markets and public spending, etc.); at other times it is understood as a way of thinking (aided by concepts like rationality, equilibrium and allocative efficiency). The latter understanding is implied when economists and lawyers develop and apply economic analysis of law. Here, "economic reasoning" refers to both deliberate efforts to apply economic insights as well as legal arguments which are very reasonable rationalized as resulting from the intent to apply economic insights.[1]

6.1.2 Courts and Legal Scholarship

The general theme in this essay is economics *in* law, not economics *of* law. The discussion is however limited to courts, and to legal scholarship focusing on courts. This of course narrows down the scope of the chapter in comparison with the breath of the underlying theme, as it is of course imperative to remember that lawyers also argue and bargain outside the courtroom and outside the scope of legal disputes.[2] The relevance of economics is clear in many such contexts, e.g., when bargaining, drafting and entering into a commercial *contract*. Moreover, when lawyers assist in *legislative* work, they should not only (in my opinion) defer to other social scientists and to lawyers who know social science. They are even under an obligation to analyse the effects of legal change and to assess its costs and benefits. This obligation is not only universal and ethically grounded, but is also a requirement in Norway and many other jurisdictions, like the US and the UK.

The practice of *judging* lies, however, at the core of professional law, at least according to traditional understandings. The reason is – as we all know – that the courts decide the precise content of the law, and that it is a profitable and professionally prestigious craft to argue before the judges and to predict and interpret their rulings. And the core of legal scholarship is closely attached to these activities. Thus, it is reasonable to assume that a discussion of economics in courts and legal scholarship may shed light on the more general theme of economic reasoning in law.

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[1] In presenting my case, which is the case of Norway since 1980, I am assuming a certain minimum knowledge concerning the perspective and methodology of economic analysis of law, see e.g. Erling Eide and Endre Stavang, *Rettsøkonomi*; Richard Posner, *Economic Analysis of Law*; Steven Shavell, *Foundations of Economic Analysis of Law*; Hans-Bernd Schäfer and Claus Ott, *The Economic Analysis of Civil Law*.

[2] See e.g. Robert H. Mnookin, Scott R. Peppet and Andrew S. Tulumello, *Beyond Winning. Negotiating to Create Value in Deals and Disputes*.

6.1.3 Norwegian Illustrations

The illustrations of and references to economic reasoning in Norwegian law are in this chapter organized along three legal dimensions: the practice of judging, the practice of courts-centered legal scholarship and the mainstream jurisprudential model of decision-making in courts ("interpretation").

The main argument for discussing the legal relevance of economics in Norway only, is that such relevance ultimately has to be judged within a given jurisdiction, and that Norway is an interesting case because Scandinavia is considered to be different from both the German-speaking as well as the English-speaking jurisdictions.[3]

Although Norway may not represent Scandinavia perfectly, it may be argued that it is the one Scandinavian jurisdiction where the discussion has been going on for the longest time and with the greatest intensity. Since 1840 Norwegian lawyers have been taught economics as part of their program of studies leading to a law degree. From 1996, the curriculum was changed from a general, broad introduction to economics to an introductory course in economic analysis of law. To pre-empt any impression of chauvinism, I hasten to add that the most prominent individuals in the relevant debates during the twentieth century – Henry Ussing, Vilhelm Lundstedt, Alf Ross and Jan Hellner – were not Norwegians, but rather Danes (Ussing and Ross) and Swedes (Lundstedt and Hellner). I maintain however, that since 1980, the leadership in the debate has gradually gravitated towards the law school at the University of Oslo. Erling Eide – the first Norwegian professional economist to take economic analysis of law seriously – was appointed Professor of Economics at this law school in that year.[4]

Although the relevance of economics is contingent on professional and political culture, as well as on social and moral norms, I would be surprised if the illustrations, examples and generalisation in this chapter were to be of no interest to those who want to explore the foundations and applications of "law and economics" in Europe, and even elsewhere.

6.1.4 Outline

Following a bottom-up sequence, three cases in torts, contracts and intellectual property that I co-decided as an appellate court judge are discussed first (Sect. 6.2). Then, three important contributions from three of my colleagues in Oslo are considered in light of my own understanding of economic analysis of law and its status and standing as a form of legal scholarship (Sect. 6.3). On the basis of this

[3] See Grechenig and Gelter, p. 297.

[4] Røsæg, Schäfer and Stavang, p. 18.

experience, I offer some thoughts on a somewhat more theorized methodological level on how to go from economic reason to legal argument (Sect. 6.4). In closing, I remark on the potentially counter-intuitive character of the claims made herein and draw some conclusions (Sect. 6.5).

6.2 Illustrating How Economics is Intrinsic in Law

6.2.1 Introduction

This section is based on my own (admittedly very limited) experience as an appellate court judge, in the Borgarting court of Norway. During the winter of 2003–2004, I co-authored over a dozen opinions, and I have selected three of them as vehicles for illustrating the relevance of economics in the Norwegian legal system.

An Apartment Sale

The first case is *a contracts case* concerning a possible price reduction for the buyer of an apartment due to the fact that the seller *ex ante* did not in fact legally control an 8 m^2 hall outside the apartment for sale, despite the fact that the hall during the contract negotiations was represented as being part of what was sold.[5]

When approaching such a case, it might be helpful to consider that a legal burden which has not been allocated by the parties should during trial, if possible, be put on the party best placed to carry it, in the sense that this party most cheaply can prevent such problems from arising, or that he has a superior capacity to carry the ex-ante risk that the costs related to such problems may entail.

In fact, the court found that this lack of legal control, which both parties failed to realize, was a risk that was to be allocated to the seller. Thus, a price reduction was rewarded. The court's main stated reason for this allocation was that to apply the opposite rule in such a case would risk sending a signal to buyers that they should use legal representation when buying an apartment. At the same time the court said that it found more appropriate that the broker (who in the Norwegian legal system is an agent for the seller but still under an obligation to take both parties' interests duly into account) possesses and uses a reasonable knowledge of real property law. Moreover, the court found that the seller in this case had failed to do so.

This analysis may not impress an economist, but the idea here is clearly to save on transaction costs (the cost of hiring a lawyer) and to allocate risk with an eye to the incentive effects of such risk allocation. Thus, economic reasoning was clearly part of the *ratio decidendi.* Such elements in the decisions of the court may

[5]LB-2003-997.

enhance future predictability to the benefit of both contracting and litigating parties. Moreover, it moves us in the direction of basing court decisions on broader notions of collective rationality – even (in) civil law cases. Such a move is reasonable given that the courts are subsidized by the public purse. Even if the economic reasoning was not necessary to reach the result (i.e. during "the process of discovery") in this case, I would claim that it was a desirable element to justify the decision at the appellate level.

In sum, this case gives some hints and indications as to how and why economics is relevant in contracts cases.

A Loss of Income After a Road Accident

The second case is *a tort case*, involving economic loss arising out of a car accident resulting in personal injury.[6] The victim owned all the shares in a small manufacturing and installation company which made its profits mainly by the extraordinary talent and efforts of the victim. The court awarded damage compensation for all lost salary. In dispute was only whether non-salary income was a protected interest in tort, either through a claim from the victim as a physical person for lost dividends, or through a claim from his company (which he fully owned) for lost profits. Both claims had been filed, but the court did not discuss the last claim, as it unanimously found in favour of the victim for his personal claim of dividends (the first claim).

Economics is a rather apparent factor in the court's reasoning, in two ways. On the one hand, there is a human capital and production theory flavour in the finding by the court that the dividends loss in reality was a loss of personal income. The court noted that the business had very low fixed costs. And even if there were a handful of other employees, the victims' working hours, creativity and personal engagement in the business was so significant that there was a negligible distinction in this case between the salary and the dividends to the victim. On the other hand, the following reasons dictated that lost salaries and lost dividends were *both* compensable. First, there was no risk of compensation for loss twice, given that the second claim was dropped given that the first claim was honoured. Second, car accident insurance would be cheaper than socially desirable if the random gain (to the injurer) of not being liable for the full harm were chosen as the solution. Third, administrative costs and related technical problems did not constitute powerful counterarguments to awarding damages for the full harm.

This is not the full story, however. The Borgarting ruling was appealed, and the Supreme Court subsequently – with three votes against two – limited the injurer's liability to the victim's salary loss.[7] The majority said it would be "unfamiliar/foreign to our legal system" if personal damage compensation of dividends to the victim was awarded, that it also would run counter to "basic company law principles" and

[6] LB-2003-14218.

[7] Rt. 2004, p. 1816.

that it would complicate computation of damages and taxes. The immediate victim was the company, and due to all the three stated counterarguments, only the latter's loss of profits was compensable – given that the company itself had sued for such damages, which it had. However, the company's loss of profits was, to the majority, so unrelated with the personal injury that it constituted a pure economic loss not worthy of compensation under current doctrine. The fact that part of the harm was thus not compensated, and that the injurer and its insurer thus benefited arbitrarily from this configuration of facts and doctrine were not deemed sufficient arguments to allow either of the two claims to be honoured. – The minority voted in favour of upholding the ruling of Borgarting appeal court, and explicitly stated that it found that the majority's position unreasonable.

For the lower court and for the Supreme Court minority, there is no doubt that economic reasoning permeated the premises of the decision. For the Supreme Court majority, it is not easy to assess the role of economics, because who can divine what is hidden in the phrases "unfamiliar/foreign to our legal system" and "basic company law principles"? It may just be that these judges held the view that what has crystallized itself as familiar and basic is precisely what is economically desirable. Moreover, administrative costs clearly entered into the majority's reasoning as a relevant component. That the majority did not tackle the economic issues head on and explicitly, however, makes its premises more muddy than necessary. The majority would have been on firmer ground had they said something like this: The loss is a pure economic loss to the company and the non-compensation of pure economic losses can in this case be defended on the grounds that if companies can seek damages for loss of income due to the personal injury of employees, this would lead to too many (difficult) cases and many uncertain measurements. Similarly, if shareholders can sue for losses suffered by companies, when losses are pure economic losses to the company, there will be many more cases that in general would have to be dealt with through class action suits. Moreover, the deterrence effect is probably small in this instance. And finally, this is the kind of loss that the owner might insure against himself through personal injury insurance.[8]

As a matter of fact, *none* of the judges in this case considered whether the dividends were components of the loss which shared its characteristics with other so-called pure economic loss. If this were the case, compensating for such loss could lead to overcompensation and to overdeterrence. In my opinion, the quality of the opinions on this issue would have benefited from better wording – for the same basic reasons as stated with regard to the contracts case above.

In sum, this case illustrates that a torts case can be decided and its justifications improved by highlighting its economic dimensions. And in contrast to the apartment case discussed above, a stronger knowledge of and commitment to economic reason might have prevented what I think in the end was the wrong result in this case.

[8]I thank Henrik Lando for this input.

A Copyright Infringement

The third case is *a widely discussed intellectual property case involving the use of a criminal sanction*.[9] It is sometimes called the DeCSS-case, also referred to as the DVD-Jon case. Jon Lech Johansen, then 15 years old, circumvented in 1999 the Content Scrambling System for DVDs, and posted this on the Internet, making the program available to persons without any special knowledge of information technology. In the appellate court, we found that the development of the program was not illegal, and that access to the films could not be qualified as unauthorized. Thus, there was no basis in Norwegian criminal law for punishing Johansen, and he was thus acquitted.

The economic reasoning of the court is sparse, and, if it exists at all, it is buried in the following paragraph of the ruling:

> It is the opinion of the appellate court that there is a qualified difference between copying a feature movie and reproducing a whole issue of a journal or a whole book. The feature movie is stored on a medium prone to be harmed like scratches, nicks and cracks, while a book or a journal may be read over and over again without reducing the quality. The appellate court bases its opinion on a DVD being vulnerable to injuries to such an extent that the purchaser must be permitted to make a copy, for instance of a movie in which he takes a special interest in preserving. One cannot see that the use of DeCSS represents any great danger for illegal reproduction of DVDs in competition with the movie producers. The legal history and the Berne Convention art 9 stipulates a weighing of interests, but in this case it is the interpretation of the copyright act sect 12 as part of an assessment of criminal law which is the issue, and in such a legal context the unconditional form of the wording of the provisions must, according to the view of the appellate court, be given considerable weight.

It is evident from this paragraph that the court may have catered to a kind of cost benefit analysis, but that it deviated from performing one because of the wording of the Norwegian copyright act.

Despite this, I would argue that this case is still a good example of the relevance of economic analysis of law. Why? First, in the proceedings of the case, significant attention was given to an expert testimony on whether or not an acquittal of Johansen in effect would transform existing DVD movies on market from a private good into a public good and thus dilutes the incentives to produce new films. In retrospect, I think that the prosecutor and her witness should have made more of this argument, not less. The witness based his statement on textbook theory without support of sufficient data, and the prosecutor did not integrate the expert testimony into her legal reasoning to a sufficient extent. If this had been done, it is not possible to rule out the possibility of a different outcome of the case, or at least a dissent, giving a reason for further appeal to the Supreme Court. And given such an appeal, which I actually think would have been appropriate in any case; an expanded version of the expert testimony could and should have been presented before the Supreme Court.

[9] 03–00731 M/02 Oslo Lagsogn.

Given a slightly different legal take on the problem, this economic analysis of law then could and should have figured prominently in the final ruling.

In sum, this illustrates that economics may well be part of the basis for deciding copyright cases.[10] In fact it was not, however. Thus, of the three case discussed, the one where the parties themselves explicitly ventured into economic reasoning, the court was more reluctant to take economic reason into account, relative to the two cases where the parties themselves did not mention such arguments explicitly.

6.2.2 General Remark in Closing

It is somewhat ironic that, of the three case discussed, the one where the parties themselves explicitly ventured into economic reasoning (Sect. "A Copyright Infringement"), the court was more reluctant to take economic reason into account, relative to the two cases where the parties themselves did not mention such arguments explicitly (Sects. "An Apartment Sale" and "A Loss of Income After a Road Accident"). Nevertheless, based on my – admittedly short – experience, I suspect that it is not rare to find cases in Norway that are fruitfully subject to economic reasoning, and laboured through the use of tools of economic analysis of law. I close this section by noting that such labouring would not be in breach of the theory of adjudication which is propagated at the University of Oslo. According to this theory, which is supported by empirical observation, policy arguments are a valid and indeed desirable part of ascertaining and deciding the law, and of justifying the particular outcome of a case.[11] And if we ask ourselves specifically how economic analysis of law fits into this theory, the answer is: not bad at all, see Sect. 6.4 below.

6.3 Fusing Economic Analysis of Law and Doctrinalism?

6.3.1 Examples

In this section, illustrations are given and discussed concerning how economic analysis of law is conducted and used among today's legal academics in Norway. I will discuss three main examples and mention several others.

The first scholarly work is Trine-Lise Wilhelmsen's monograph on unconscionability and other grounds for reasonableness-based invalidation and revision of contract terms; see the Norwegian Contract Formation Act, section 36, versions

[10] Stephen Breyer, 'Economic Reasoning and Judicial Review' (discussing, i.a., a US copyright case).

[11] The canonical exposition is Torstein Eckhoff, *Rettskildelære*.

of which appear in all the Nordic jurisdictions.[12] The *theme* of the monograph is to what extent this law contributes to economic efficiency.

To understand the *method* of the monograph, it may be useful to compare it with the much earlier study by Posner and Rosenfield on impossibility.[13] There, the issue for decision is considered in respect of the party who should bear the loss in the typical case in which an unforeseen event makes the cost of performance exceed the benefits, such as war (events with general effects) and death (events with individual effects). Thus, the object of study is the legal solution to the discharge problem, which is dealt with by the doctrines of impossibility, frustration, and impracticability. If any of these doctrines apply, the promisor is excused for non-performance, and the promisee is only entitled to the restitution of value of actual benefits to the promisor. According to Posner and Rosenfield, the efficiency-based prediction is based on two analytical elements. The first element is to establish proper incentives for care and insurance, that is, that discharge should be allowed where the promisee is the superior risk bearer. The second element which underlies the prediction is the economics of rules versus standards, that is, an analysis which takes into account the costs and benefits of deciding case by case. The analysis leads Posner and Rosenfield to conclude "that the doctrine exemplifies the implicit economic logic of the common law".[14]

Wilhelmsen's monograph is structurally similar to Posner and Rosenfield's study, but there are some differences. Her main basis for deriving efficiency implications is Cooter and Ulens framework for the economic analysis of contract law as set out in their textbook.[15] This gives a more general approach based on the notion of perfect markets and contracts. The various parts of article § 36 and the underlying case law is then thoroughly analysed and compared with what would be efficient given assumed relevant market and contract imperfections. Like Posner and Rosenfield, Wilhemsen thus identify the economic decision problem regardless of doctrinal distinctions, and specify an efficient solution to the legal problem. Unlike them however, Wilhelmsen does not discuss whether the solution should be implemented as a rule or at the level of individual cases. On the contrary, she compares the actual outcome of each case with the "efficient" outcome of the same case. Wilhelmsen's result is that the correspondence is 80 %, but she avoids the claim that she "explains" the law by exposing this "empirical" correspondence. She does, however, interpret the result as having legal significance.

The second scholarly work is Hans Christian Bugge's monograph on environmental civil liability (and the PPP, i.e. "polluter pays principle").[16] The book is

[12] Trine-Lise Wilhelmsen, 'Avtaleloven § 36 og økonomisk effektivitet'.

[13] Richard A. Posner and Andrew M. Rosenfield, 'Impossibility and Related Doctrines in Contract Law: An Economic Analysis'.

[14] Posner and Rosenfield, p. 84.

[15] Cooter and Ulen, chapters 6 and 7.

[16] Hans Christian Bugge, *Forurensningsansvaret. Det økonomiske ansvar for å forebygge, reparere og erstatte skade ved forurensning.*

mainly a detailed exposition and analysis along doctrinal lines, but the law is in addition commented upon in light of three normative criteria: the ecological goal to keep the environment clean, the economic goal to minimize social costs, and the legal goal to pursue justice. The criteria themselves are thoroughly described in separate parts and are then used at various stages throughout the book as a basis for remarks on the law. An overall message of the book is that the polluter-pays principle (PPP) is more ambiguous than what was thought at the time. The principle originates in environmental economics and the idea that all resources – including natural resources and other environmental qualities – will be efficiently managed if all costs – environmental costs included – are internalized in the operating decision system of the polluting firms. When the positive effect of the environment for the welfare of all individuals thus are duly taken into account, then the firm will count environmental harm caused by the firm as a cost. But despite this clear PPP concept, the PPP notion is in practice used in several ways, and Bugge discusses the various legal implications of different interpretations of the PPP.

The third scholarly work is Gunnar Nordén's article on the legal regulation and position of the Norwegian Central Bank.[17] The article concerns the legal autonomy of the Bank and analyses whether the central government is legally competent to give instructions to the Bank, and whether the Bank is under some kind of duty to adhere to "political signals" (in the form of budget documents, etc.) from Parliament. Nordén asks specifically how statutory language on the Bank's legal position is to be interpreted in the light of this overall theme. His analysis contains an ambitious combination of formal norm-analytical discussions in the Scandinavian legal realist tradition and game-theoretical discussions of the dynamic consistency issues that can be raised within the institutional arrangements in question. Nordén's result is that the Norwegian central bank has – de lege lata – more autonomy than what conventional legal wisdom postulates, and that, on the level of the theory for legal interpretation ("rechtsquellen-lehre"), we must reject in statutory interpretation the use of budgetary documents and similar sources produced by the political system after the promulgation of the statute.

I will now discuss some differences between these three contributions and also try to assess their qualities with regard to their use of economics and to their representativeness in this respect.

The three contributions are different in that Wilhelmsen's studies of whether judges are in fact reasoning in line with economics when they decide on unconscionability, Bugge discusses the role (partly economic) of a legal principle, and Nordén uses economics to interpret the law – three very different uses of economics in law indeed. The main parameter, however, that I will use to *distinguish* the works are the sophistication and internalization by the author in question of the economic analysis that is used to produce the text, and the relative attention that is paid to this aspect of the overall problem. Here, it is Nordén and Wilhelmsen who pay most

[17]Gunnar Nordén, 'Norges Banks rettslige stilling: En systemorientert analyse med implikasjoner på nivået for juridisk metode'.

attention to economics and of these, Nordén is clearly the one that has internalized economics the most. The internalization by Bugge is comparable to Wilhelmsen's, but in contrast to her (and to Nordén), he "puts economics in its place" by giving it the role as the second of three analytical pillars/values and thus limits the attention to it accordingly.

All three works have been received as contributions to Norwegian legal scholarship at the highest level. I do not seek to second-guess these assessments of quality. Rather, I will try to assess whether they are good models for others that want to do legal scholarship at PhD-level or beyond.

Nordén's sophistication is outside the reach of almost all legal scholars. Moreover, I admit to a certain scepticism regarding his use of symbolic notation and a very developed level of formal reasoning. The basis of my scepticism is that he postulates that his work has a legal-practical purpose, and to me, that clearly constrains the appropriateness of formal analysis, at least when it is not translated and transparently integrated into the (other) legal reasoning.

Bugge's work seems to me the better model for most legal scholars aspiring to incorporate economic analysis of law. The economics is clearly set out, and the relevance is made apparent in a commonsensical, although not trivial, way. I do think, however, that he discusses so many topics that his normative analysis is more superficial than necessary. And to me, this actually results in a rather fundamental crack in the foundations of his monograph. In the midst of his discussion, he pauses to note that he cannot take his "three-goal-analysis" further, but that "the law as it is", that is, the law which is valid (the Scandinavian term is "*gjeldende rett*") – which he describes elsewhere in his monograph – in any case shows how his three goals are relevant, and the extent to which legal significance ("weight") is attached to each goal. To me, this is not a satisfactory solution, and I think Bugge could and should have allowed himself to integrated legal description and goal analysis more by narrowing the range of topics discussed in the monograph. In fact, one could go so far as to argue that Bugge does not sufficiently appreciate that economics does not represent one of several goals but is rather a goal-instrument analysis that can incorporate many kinds of goals, including fairness, legal security, etc.[18]

I would place *Wilhelmsen's* work in an intermediary position between Bugge's and Nordén's. The reason I think that Bugge's work is a better model for more legal scholars open to economics than Wilhelmsen's, is that he pays more attention to other relevant perspectives than economics. But for the minority of legal scholars that aspire to *specialize* in (the application of) economic analysis of law, Wilhelmsen's work is clearly the better model. Arguably, however, her monograph suffers from a somewhat mechanical use of the perfect competition model; the perfect competition model might not be all that reliable for analysing contract law. Instead, one might, at least today, think that contract theory with the assumption of incomplete contracting should be used more directly to throw light on the legal issues. In other words, the perfect competition model may simply not be the most

[18] I thank Henrik Lando for emphasizing this point in our communication.

fruitful benchmark; presumably one should try to find a theoretical framework as close as possible to the real issues that are involved in cases of unconscionability.[19]

Turning to the representativeness of the three texts, Nordén's article may be categorized as part of "*market law*", broadly conceived. During the last 15 years, at least four "market law PhDs" have been produced which pay significant attention to economic analysis (of law).[20] Thus, even if Nordén's work is somewhat idiosyncratic (and original), his work is in line with a trend in Norwegian market law scholarship at PhD level. Bugge's work falls within *environmental law.* In Norway, it is atypical to do environmental law and economics. This may be surprising, because social concerns and the need for balancing of interests are so obviously important in this field. But Bugge's is not the only exception.[21] Wilhelmsen's monograph contributes to *contract law.* It may come as a surprise that there are only three other contributions in this field which utilize an economic approach.[22]

Finally, it should be emphasized that these and other contributions show that the level of ambition with respect to the sophistication, internalization and use of economics can vary along a wide spectrum. At one end, lawyers are open-minded towards economics and to what economists have to say.[23] Moving from there, we come to studies where lawyers acquire, self-consciously or not, a taste for economic reasoning.[24] Further along the spectrum, we find explicit applications of economic reasoning and results.[25] If the economics is sufficiently internalized, we reach a point where the application itself is also a contribution to economics, but

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[19]I thank Henrik Lando for emphasizing this point in our communication.

[20]Olav Kolstad, *Fra konkurransepolitikk til konkurranserett: samfunnsøkonomisk effektivitet i den konkurranserettsligeanalyse*; Helge Syrstad, *Sentralbankens uavhengighet: en analyse av rettsforholdet mellom sentralbanken og de politiske myndigheter*; Eirik Østerud, *Identifying Exclusionary Abuses by Dominant Undertakings under EU Competition Law: The Spectrum of Tests*; Inger Berg Ørstavik, *Innovasjonsspiralen: patentrettslige, kontraktsrettslige og konkurranserettslige spørsmål ved forbedring av patenterte oppfinnelser*.

[21]Beate Sjåfjell, *Towards a Sustainable European Company Law. A Normative Analysis of the Objectives of EU Law, with the Takeover Directive as a Test Case*; Endre Stavang, *Naborettens forurensningsansvar – prinsipper for tålegrensevurderingen.*

[22]Namely Petri Keskitalo, *From Assumptions to Risk Management: An Analysis of Risk Management for Changing Circumstances in Commercial Contracts, Especially in the Nordic Countries: the Theory of Contractual Risk Management and the Default Norms of Risk Allocation*; Henrik M. Inadomi, *Independent Power Projects in Developing Countries: Legal Investment Protection and Consequences for Development*; Inger Berg Ørstavik, *Innovasjonsspiralen: patentrettslige, kontraktsrettslige og konkurranserettslige spørsmål ved forbedring av patenterte oppfinnelser*.

[23]Helge Syrstad, *Sentralbankens uavhengighet: en analyse av rettsforholdet mellom sentralbanken og de politiske myndigheter.*

[24]Hans Jacob Bull, *Tredjemannsdekninger i forsikringsforhold: en studie av dekningsmodeller, med basis i sjøforsikringsretten og i petroleumskontraktenes ansvars- og forsikringsregulering*.

[25]Olav Kolstad, *Fra konkurransepolitikk til konkurranserett: samfunnsøkonomisk effektivitet i den konkurranserettsligeanalyse*; Olav Kolstad, 'Konkurranseloven som virkemiddel til å fremme "forbrukernes interesser"'; Endre Stavang, 'Tolerance Limits and Temporal Priority in Environmental Civil Liability'; Endre Stavang, *Naborettens forurensningsansvar – prinsipper for tålegrensevurderingen*; Endre Stavang, *Erstatningsrettslig analyse – med særlig vekt på eiendom*

that is beside the point here. More important is the next point as we move along the spectrum, which are the economics-based empirical legal studies.[26] And at the (other) end of the spectrum, we find contributions to the theory building within economic analysis of law.[27]

6.3.2 The Demarcation Problem

Many if not most legal scholars, at least in Europe I think, internalize the core expectations from both the world of professional action and the world of academic analysis and reflection. A certain closing of the legal mind may seem warranted, and a traditional lawyer might respond to all of the above: *should not the legal profession protect its own discipline and method while admitting fruitful contributions from economics – how do we prevent interdisciplinarity from going too far or from turning sour?*

My answer to this is twofold. First, economics is, as indicated in Sect. 6.2, often embedded in legal problems in such a way that it is quite natural for a legal scholar to elaborate also on the economics of his or her subject matter. Thus, it may come as no surprise that the scholarly works mentioned in Sect. 6.3 have all been accepted as legal scholarship. According to formal Norwegian regulations for academic employment and promotion, they are thus counted as "legal science" (rettsvitenskap, Rechtswissenschaft). And second, within the professional world, which Sect. 6.2 draws from, there are very strong forces at work determining what can and what cannot survive. Personally, I doubt that creativity in legal research is currently at a level in Norway where there is a danger that the joint forces of academic research ethics and professional guild-like interests will be too weak to protect the discipline and methods of law. This also goes for the rest of Scandinavia, I should think. And how this problem is to be evaluated in other jurisdictions around the world, I leave to others to ponder.

Thus, my conclusion is that economic analysis of law has, since 1980, established itself as a branch of (interdisciplinary) legal scholarship – just like it has previously in many other jurisdictions. One reason for this positive outcome, I think, is that Norwegian legal culture is pragmatic and open for at least moderate forms of utilitarianism-inspired scholarly work. One might even say that a tradition of doing "law and economics" in Norway existed both inside and outside legal academia

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og miljø; Endre Stavang, *Opphør av servitutter*; Trine-Lise Wilhelmsen, *Årsaksproblemer i erstatningsretten – årsakslærer, formålsbetraktninger og økonomisk effektivitet.*

[26] Erling Eide, *Economics of Crime. Deterrence and the Rational offender*; Anders Christian Stray Ryssdal, *An Economic Analysis of Civil Suits and Appeals*.

[27] There are no Norwegian equivalents to Guido Calabresi, *Costs of Accidents*; Guido Calabresi and Douglas A. Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' and Richard A. Posner, *Economic Analysis of Law.*

during the period of 1814 and up until the Second World War.[28] The discussion in Sect. 6.4 suggests, moreover, that worries are needed on the level of current legal theory about potential problems of transforming economic reason to legal argument.

This conclusion, that one can *safely – at least to a reasonable extent* – do "law and economics" and still be a legal scholar, with the possible effects this may have on academic employment as well as on intangibles, seems correct, based on the observations in this essay. Moreover, I would like to suggest adherence to the following main rule: When a scholar with professional training in law applies economics or does economic analysis of law, the outcome is, if the work satisfies the formal quality criteria, to be deemed a contribution to legal scholarship in the German/Nordic sense of the word (Rechtswissenschaft, rettsvitenskap, "legal science"). I predict that this rule is subject to a very narrow exception, if one exists at all.

Let me end by trying to spell out clearly what I take as the essential inference from all of this. It is not just that economic analysis of issues can be used to throw light on questions relevant to legal scholars and judges, nor is it merely that many issues in legal scholarship that can benefit from an economic perspective. To amplify my conclusion, it is that the concept of "rettsvitenskap" has changed. As a matter of principle, this means that economic analysis of law should now be regarded as commensurable with other forms of legal scholarship. As a practical matter, this implies less discrimination against interdisciplinary legal scholarship and thus more competition for professorships in law previously monopolized in Scandinavia by so-called legal-dogmatic scholars in the narrow sense, that is, "pure" doctrinalists.[29]

6.3.3 The Way Forward

I will close this section by commenting briefly on the three ways Anthony Ogus recently suggested that a legal scholar wanting to "do" economic analysis of law should consider when approaching a field of legal research.[30]

The first approach is to look for problems within the law where an economic understanding has been *underappreciated.* Ogus' point here can be related to my examples in Sect. 6.2 which can be understood as suggesting the need for the study of risk allocation and incentive considerations, in three different areas: IPR rights, the expansion of tort law to cover pure economic loss, and the likewise old issue of the consequence of mutual mistake in contract law. I think it is worth mentioning

[28] Stavang, 'Welfare-Based Torts', pp. 28 et seq.

[29] For sake of good order, I add that I count myself as a legal-dogmatic scholar, although not in the narrowest sense, that is, I do not claim to be "pure".

[30] Ogus, pp. 173–175.

that there is ample room for simple risk/incentive/administrative cost analysis of old legal questions, besides the rather more abstract and/or professionally advanced uses of economics.[31]

The second approach is to venture into the field of *empirical* legal studies, for example by teaming up with other scholars that master statistics and econometrics. As the examples mentioned in Sect. 6.3 indicate, both a lawyer (like Ryssdal) and an economist (like Eide) can perform such studies alone, but I think multiperson projects might more often than not be desirable within this approach to legal scholarship. As my own experience in this field approximates zero, I leave to others to develop this further.

The third approach is to integrate the partial but valuable insights gained by economic analysis of law into the more complicated and multifaceted normative spheres of legal interpretation, construction and critique. As I see it, this is the most useful and promising approach for lawyers to take when taking on economic analysis of law. Moreover, I contend that it follows from my analysis in Sect. 6.4 that, on a methodological level, time has come to acknowledge the *fusion* of economic analysis of law and doctrinalism as *one* way of contributing to legal scholarship. The Norwegian case since 1980 suggests that this is feasible. And to rephrase a line from Steven Shavell, this will be both intellectually satisfying as well as preventive of undesirable decisions made within the legal system.

6.4 Bridging Economic Reason and Legal Argument

6.4.1 Introduction

One might think that the discussion in Sects. 6.2 and 6.3 above, although casuistically, sufficiently (for one short essay) illustrates how economic reasoning can play a role as legal argument in Norwegian law, and that this in itself can be taken as potential lessons for others.

However, some might have unease with such a casuistic approach. A European lawyer might e.g. view the discussion so far as too much "scattered rules" and too little "system and principles (coherence)".[32] Moreover, is might seem to some that the use of economic reasoning in law is inherently political, and that there is a need to make this legitimate on the level of legal theory. In other word, how can economic

[31] Thanks to Henrik Lando for emphasizing this point in our communication.

[32] See Régis Lanneau, 'To What Extent Is the Opposition Between Civil Law and Common Law Relevant for Law and Economics?' and Aurélien Portuese, 'The Case for a Principled Approach to Law and Economics: Efficiency Analysis and General Principles of EU Law'.

arguments be transformed to legal ones? This issue has been discussed in Norway since the early 1990s, and in this section, I will summarize an updated version of my own account.[33]

The point of departure from a jurisprudential point of view, given the Norwegian jurisprudential model of judicial decision-making and welfare economics, is that clear-cut implications of economic reasoning are allowed to enter because "values" or "arguments of substantive goodness" and ideas of substantive justice are seen as intrinsic sources of law. However, these arguments are accepted low weight (according to collision principles) if not backed by more authoritative sources of law. Against this background, I identify and describe three mechanisms through which other sources of law may, when (re)assessed, support the (more) socially desirable solution to the legal problem with additional weight. First, there are substantial areas where private autonomy prevails, e.g. in the law of nuisance and servitudes (Sect. 6.4.2). Secondly, internalization of risk and harmful effects is clearly an operating form of "zweck-rationality" in Norwegian law, e.g. in relation to strict liability in torts (Sect. 6.4.3). Thirdly, direct balancing of interests, which often appears to be consistent with welfare economics, is regarded as important in Norwegian legal reasoning (Sect. 6.4.4).

6.4.2 Private Autonomy

There is a tendency in economic reasoning to prefer outcomes of allocative processes that are set up, when feasible, so that each party is free to say yes or no, and to negotiate, i.e. which are based on markets and on "property rules".[34] The sale of the apartment referred to in Sect. 6.2 is clearly an example. Property rules and private autonomy are interlinked, and Wilhelmsen's study referred to in Sect. 6.3 suggests that this bridge between welfare economics and the law is for real. Thus, private autonomy is a *possible* rhetorical mechanism for transforming an economic reason to legal argument.

Sometimes the legislator explicitly *prescribes* a bias towards private autonomy, as when the Norwegian statutes on co-ownership (joint tenancy), servitudes and nuisance announces that the legal rules, as a starting point, are only default solutions that the parties may opt out of by contract or by legally relevant cooperative behavior.

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[33]Endre Stavang, *Verdiskapingshensyn og juridisk argumentasjon – særlig om lokale miljøskader*; Stavang, *Erstatningsrettslig analyse*, Chapter one. See also Eide and Stavang, esp. Chapter 26. A notable later Norwegian contribution building on this is Olav Kolstad, 'Rettsøkonomi i juridisk argumentasjon'.

[34]The theoretical case for property rules is clearly more attenuated than for markets, see Ayres, p. 200 (no general theory exists).

At other times, it is quite reasonable to *infer* that private autonomy is closely linked to welfare economics, at least within the law of real property. To illustrate, in Norwegian-Danish law of servitudes, the ex-ante controls on creating servitudes are weak and few, whereas the explicit rationale for the existence of servitudes in these jurisdictions, and also elsewhere, is that each servitude produces greater utility than disutility, as seen from the perspective of the typical parties holding the rights to the relevant land.[35]

A special case is the *hypothetical contract*. If a servitude is created by the doctrinal equivalent to adverse possession, it is natural but clearly not decisive that the scope of the created right is connected to the character and extent of prior use. Another important consideration is what scope of the right the parties most likely would have bargained for in a setting of smaller transaction costs.[36] This approach to the delineation of rights is also in use as matter of contract interpretation, and as such it may be seen as means of approximating party autonomy and welfare economics, although not a perfect means in all situations.[37]

Moreover, the Norwegian law of remedies as applied to property in land has, as a way of usefully adding to the basic tort-right to compensation for economic loss, several instances where there are *quasi-contract* delictual liability, i.e. the right to be compensated against the benchmark of what the price would have been had the parties agreed in a negotiation. Such add-on rights to compensation may very well increase deterrence and spur negotiated solutions, although perhaps not as much as punitive damages in some instances. A recent example is the Norwegian Supreme Court case in Rt. 2011 p. 228, where a land developer had knowingly and willingly breached a negative servitude by erecting two rather big buildings rather than one small, as the servitude prescribed. The court awarded – based on quasi-contract – compensation in excess of the economic loss to the servitude holder, but did not order the land developer to disgorge all his profits, nor did it award punitive damages.

As final examples, Norwegian law illustrates that party autonomy considerations and welfare economics might be linked and combined in useful ways in the management of other resources than land, e.g. fish stocks and carbon emissions.[38]

[35] Stavang, *servitutter*, pp. 191 et seq.

[36] Falkanger and Falkanger, p. 315.

[37] Ian Ayres and Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules'.

[38] Peter Ørebech and Torbjørn Trondsen, *Rettsøkonomi for fornybare ressurser. Teori og empiri – med særlig vekt på forvaltning av fiskeressurser*; Endre Stavang, 'Property in Emissions? Analysis of the Norwegian GHG ETS with references also to the UK and the EU'.

6.4.3 *Internalization ("Pricing") as a Form of Zweck-Rationality*

In contrast to property rules, liability rules works by both allowing and pricing transfers of resources, including harmful behavior, as in the case of the Pigouvian approach to environmental taxation.[39] The income loss/road accident case discussed in Sect. 6.2 may illustrate how such economic reasoning may be used in private law as well. Thus, the proper pricing of resource transfers (including harmful behaviors) is also a possible rhetorical mechanism for transforming an economic argument to a legal argument.

The underlying concept in legal reasoning for pricing is a more general consensus that the law, including private law, should not be an end in itself, but, at least to some extent, a means to increase human welfare. This sentiment can be illustrated by the (older) development of strict liability in torts, as well as by the (newer) legal rhetoric on environmental liability.[40] The definition of compensable value of property in the Norwegian statute on takings, which states that value means an ordinary buyer's willingness to pay for the property, is consistent with this reasoning.[41] Thus, it seems generally important, in fields like torts, takings law and environmental law, to "get the prices right". This is also acknowledged in resource rent taxation, which is an important field in jurisdictions with relative natural resource abundance, and also in ordinary property taxation.

However, it is not always the case that economic reasoning transforms easily and results in improved legal decision-making, as the following example shows.[42]

When the loss of a future stream of income is to be compensated, the yearly sums must be added and "capitalized", i.e. its net present value must be calculated. A crucial component is then the interest rate. If a positive inflation rate is expected, one technique is to inflate each yearly amount accordingly, and then find the net present value using the nominal interest rate in the market. Another technique is to sum up without inflating each yearly amount, but then use the real interest rate in the market for capitalization purposes. The Norwegian Supreme Court consistently mixes these approached by summing up without inflating while still using a nominal market rate to find net present value. This pricing error obviously leads to under compensation and may very well lead to significant social loss in terms of too much taking of property, too many personal injuries, and so on. My view is that this legal anomaly is to be corrected and that it cannot be taken as evidence of the irrelevance of economic reasoning in law.

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[39] For example William Baumol and Wallace Oates, *The theory of Environmental Policy*; Alfred Endres, *Environmental Economics*.

[40] Stavang, 'Welfare Based Torts', pp. 24–29; Endre Stavang, 'Two Challenges for the ECJ when examining the Environmental Liability Directive'.

[41] Statute number 17, 1984, article 5.

[42] Erling Eide, 'Kapitaliseringsrenten og Høyesteretts misforståelse'.

6.4.4 The Weighing of Interests

Sometimes property rules and liability rules are combined, so that behavior with external effects are allowed up to a certain threshold level without any pricing, and then priced by a liability rule or sanctioned by a property rule beyond that level.[43] When insertion of thresholds in the law results in such "hybrid rules", it seems generally socially desirable, from a welfare economic point of view, that the thresholds are set to reflect the relative magnitude of the interest on each side of the relevant equation. The kind of balancing lacking in the DVD-Jon case discussed in Sect. 6.2 (of ex ante disincentives to produce versus ex post increased use) can illustrate this general point. And since balancing or weighing of interests is such a familiar feature of law, this seems like a quite natural rhetorical mechanism for transforming economic reasoning to legal argument.

The so-called "Nordic theory of unlawfulness", developed from 1870, and onwards, emphasized, using contemporary jargon, the centrality of cost-benefit reasoning to determine the abovementioned threshold levels. Although the theory was later criticized and lost hegemony as a general legal theory, its spirit clearly has survived in Norwegian tort law.[44]

Moreover, the Norwegian statute on taking explicitly demands that any taking of property clearly results in greater utility than harm.

This is not to say, however, that a simple requirement of a benefit/cost ratio greater than one is all that can be said about threshold levels in the law. To illustrate, even when put in a welfare-economic nutshell, the principles of Norwegian nuisance law for determining the threshold levels of pollution in the environmental liability context, must include at least the following three elements[45]: First, there are some legal principles that can be taken to describe desirable polluter behavior. Most prominently, under the test of "unnecessary pollution", the polluter may be held to a cost-benefit standard of care. However, since information about ways to abate and how much it costs may be scarce, this basis for liability does not guarantee optimal behavior. Some of this imperfection may be overcome by the factor of "unusual harm" under test of "unreasonable pollution", because what is usual may reflect an efficient community standard. Second, under the general principles of unreasonable pollution, the rule may be characterized as strict polluter liability with the defense of contributory negligence. However, case law concerning the factor of "expectable harm" seems to imply some strict neighbor liability, as well. Whether the factor of expectable harm worries too much about the activity level of neighbors, relative to the activity level of polluters, is hard to say. Third, under the *special rule* that regulates what amounts to unreasonable pollution, characterization is difficult.

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[43] Cooter, p. 1526; Kaplow and Shavell, 'Property Rules', p. 723 (footnote 27), see also pp. 749 et seq. and 753 et seq.

[44] Stavang, 'Welfare-Based Torts', pp. 13–19.

[45] Stavang, 'Tolerance Limits', p. 573.

"Substantial deterioration for a distinguishable group" may be applicable where it is relatively important to regulate the activity level of the polluter, and/or where an insurance rationale for compensation applies.

6.4.5 Closing Remark

It may be that legal realism and pragmatism are stronger traditions in Norway that elsewhere in Europe, so that this "theoretical basis" for bridging economics and law cannot be used elsewhere in Europe. However, whether economic arguments fit the system must in practice, as I see it, be discussed with respect to each "compartment" of the law, e.g. criminal law, procedure, constitutional law, private law and so on. This is a task for a treatise, not a book chapter. In this chapter, however, it has been indicated how economic reasoning relates to those legal metaprinciples that govern legal argumentation de lege lata, as exemplified by the "canonical" model in Norway of legal reasoning, and with examples taken from Norwegian laws of property and obligations. On the level of accepted (in the sense of "herrschende meinung") legal theory in Norway, the starting point is quite simple. Welfare-economic arguments are intrinsically relevant in legal decision-making de lege lata because they belong to a family of arguments that relates to what characterizes a good decision.[46] Without support in formal authority, however, the force of such arguments may be rather small also in Norway, even if it shown in Sect. 6.2 how they are relevant and potentially important also in this setting. But, obviously, the intrinsic argumentative value of welfare-economic arguments can be enhanced by explicit references to such arguments in the legal rules.

It must be admitted that the mechanisms described, which in effect may accord welfare economics considerable weight within the accepted decision-making model, also seem to be operating with regards to other ideas of substantive justice as well. I do not consider, however, whether or not other ideas of justice are at once preferable to and inconsistent with welfare economics. The analysis is still of some value. First, if the purpose of an analysis is explanation, and this ambition is not solely to rely on an internal legal perspective, i.e. how legal actors acting for legal reasons perceive their own activities, there is always a challenge for the analyst to come up with explanatory mechanisms.[47] Let's say for instance that one observes a correlation between the dictates of efficiency (within a given model or set of models) and actual legal rules and reasoning. Then this does obviously is not sufficient as an explanation. What one need is to describe certain social or otherwise meaningful constructs that might mediate and make persuasive the efficiency "explanation". I would suggest that, as one possibility, the rhetorical mechanisms described in

[46] Eckhoff, *Rettskildelære*, Chapter 14; Stavang, *Verdiskapingshensyn*, pp. 8 et seq.

[47] See Diego Moreno-Cruz, 'Three Realistic Strategies for Explaining and Predicting Judicial Decisions'.

this section may come to some use in descriptions with the purpose of explaining observations of efficient legal rules in private law. The explanatory power of the mechanisms is probably low, since the social norms do not seem to eliminate judicial discretion. On the other hand, the efficiency hypothesis of "jurist-made" law cannot be considered improbable by mere reference to the theory (model, doctrine) of legally binding social norms of judicial decision-making. Thus, the analysis makes a (very) minor, but distinct contribution to the positive economic analysis of law.

If, on the other hand, the purpose of the analysis is some kind of legal analysis – *de lege lata or de sententia ferenda*, my claim here is that the discussion in this section suggests that worries are not needed on the level of current legal theory about potential problems of transforming economic reason to legal argument. The discussion in this section suggests three "rhetorical mechanisms" that may help in the transformation of economics to law, or, to rephrase, that creates a kind of overlapping normative territory shared by (top-down) welfare-economic reasoning and (bottom-up) legal intuition and knowledge. The analysis thus contributes to normative legal theory by showing judges how they (at least in some areas of the law) might simultaneously show a concern for welfare economics and still conform to social norms of legal decision-making.

All in all, I have developed my thoughts on the basis of Norwegian law, but I would be surprised if they were to be completely falsified elsewhere in the Nordic countries. And I would hope that the discussion also adds some value to the discussion in the other European jurisdictions, and even elsewhere.

6.5 Conclusion

This essay has illustrated how economics may be inherent in legal problems, and examples have further been given – in three dimensions – as to how this intrinsic legal attribute may be explicated. First, three cases were presented and the actual and/or potential use of economic reasoning in all three of them were highlighted. Second, three works of courts-centered legal scholarship and their use of economics were presented and put into perspective. Third, the canonical model in jurisprudence in Norway was considered, and three rhetorical mechanisms consistent with both theory and practice were identified, resulting in an increased plausibility for a claim that economic reasoning is both legitimate and a fruitful rationalization strategy at the level of legal theory.

It may come as a surprise to the *legal professional* that economics has such (potential) legal significance as propagated in the above. One explanation of a surprising effect may be that economic forces and ideas have influenced law over an extended period of time, and that a certain implicit economic logic or structure of the law has become part of the profession's tacit knowledge. However, it is also possible that the relevance of economics is currently underestimated, and that at least European lawyers need to devote more attention to economic analysis of law. And it is not obvious that this need is greater the more "economic" the legal subject

matter is conceived to be. In legal matters related to money and banking, tax law and competition law, professional economists will often contribute as judges, witnesses or back-office consultants. The practicing lawyers will be more on their own in run-of-the-mill cases like those encountered in Sect. 6.2 above.

All in all, I infer that more emphasis on fusing economic analysis of law and doctrinalism will benefit the profession and society by both helping as well as scrutinizing lawyers and judges, and that this benefit on the margin exceeds the opportunity cost of less purely empirical work and less pure doctrinalism. Such fusion should include theorizing the sources of law and their application to help lawyers and judges stay within the law while making use of economic insights and also to describe mechanisms making the positive economic theory of judge-made and litigation-driven law a more plausible explanatory theory, whatever corroborating evidence may be compiled in favour of such a theory.

Acknowledgement Presented and discussed in seminars/workshops in Frankfurt (IVR 2011), Oslo ("The Grill" 2012), Bergen (Ph.D. in Law-seminar 2012), Lucerne (Law and Economics in Europe 2012), Toronto (CLEA 2012) and Tucson (AZ Law Enrichment 2012). In addition I perhaps somewhat indulgently acknowledge my indebtedness to Guido Calabresi (my friend and teacher), Ronald H. Coase (my favourite economist) and Richard A. Posner (whose 1990 book on Jurisprudence provoked and encouraged me to analyse the questions discussed in this essay as a [sometimes interdisciplinary] legal scholar).

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