

## Notes on Exculpatory Clauses

An *exculpatory clause* is the negation of a legal ruling (*default rule*) if parties involved explicitly expressed ruling(s) contrary to the default rule. It should be noted that many ostensible exculpatory clauses are either invalid or redundant.

If they are allowed, the final assignment of liability does not depend on the initial allocation of liability. This is because products, like Coke, could simply say that they are not liable for exploding bottles (and it will do so if its profit is higher than when it is not liable) when they are liable by default. In this situation, if it is instead true that it is more profitable for Coke to be liable, it will have no need to print anything on the Coke bottle. This also occurs when Coke is risk neutral and at least some of its customers are risk averse. Thus, the only effect that the rule has when exculpatory clauses are allowed is on the amount of printing or other costs required to write the exculpatory clause (transaction costs). Coke will therefore provide the warranty (insurance policy) if it can charge more for the warranty than it costs Coke to provide the warranty.

Note that the lack of liability by the seller does not imply that the seller does not have the proper incentives to provide the optimal amount of safety. If safety is cost effective (its cost is less than the expected damage reduction from its use), then the seller will provide that safety.

When both sides are equally good insurers and both sides are informed about the risks, the outcome is the same whether the producer is liable or not. Here, it also does not matter whether exculpatory clauses are allowed or not.