



University of Zurich

Faculty of Law
Fall Semester 2012

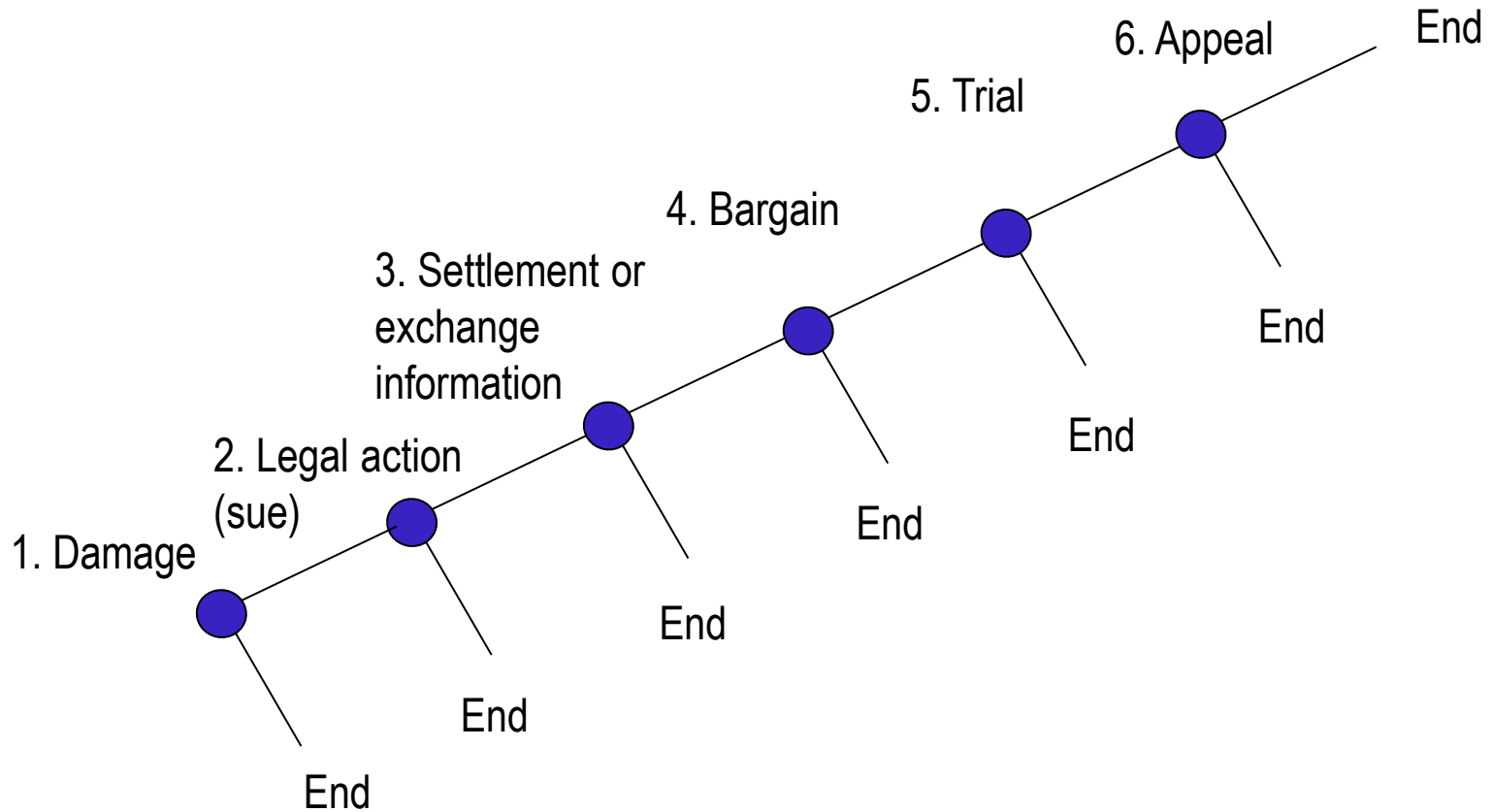
Law & Economics

Economic Analysis of Law

Procedural Law

Prof. Dr. Andreas Heinemann/Dr. Mark Steiner
Slides by Prof. Dr. Rolf H. Weber / Dr. Mark Steiner

Stages in a Legal Dispute (1)



Stages in a Legal Dispute (2)

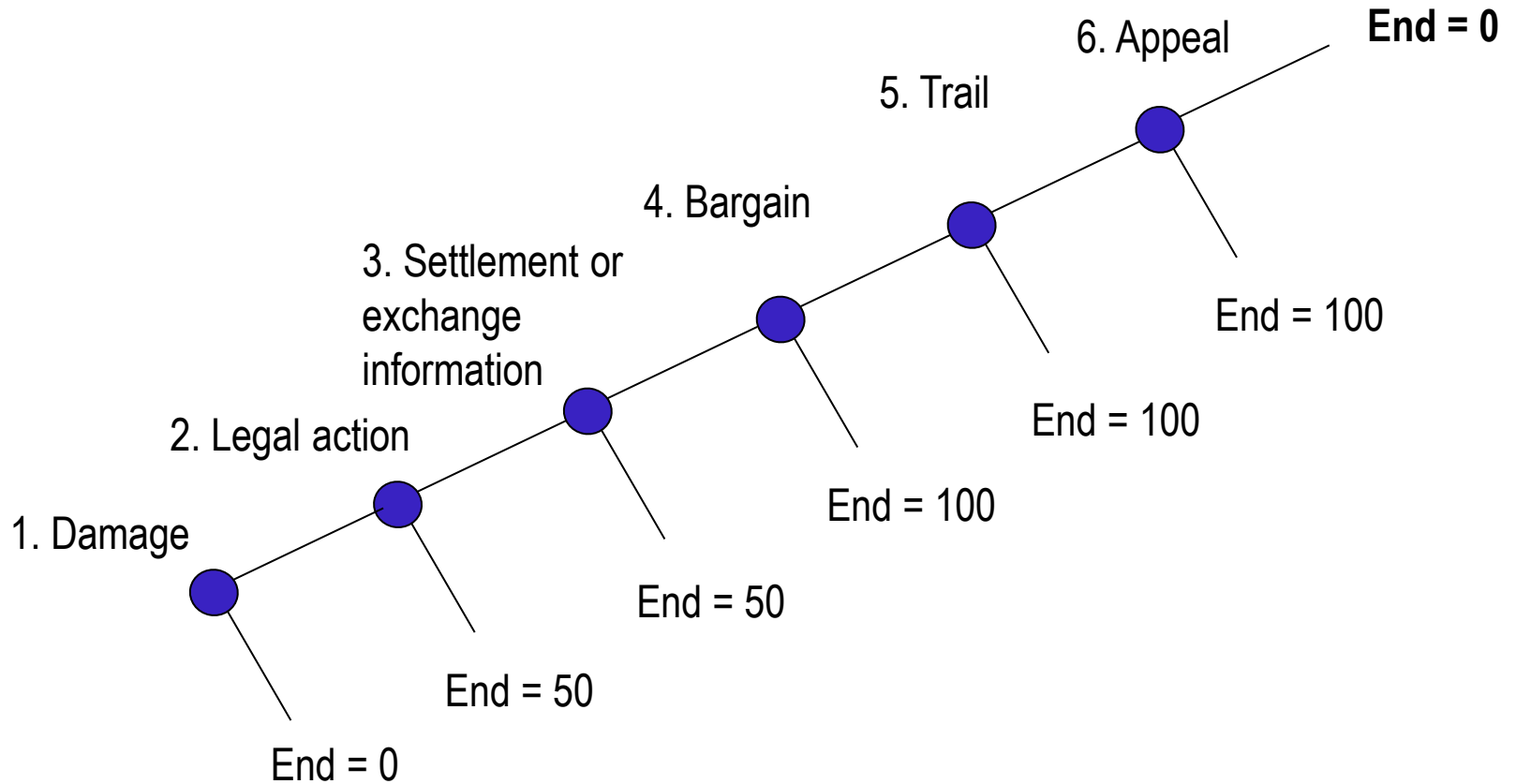
- **1. Damage**
 - Causal connection between injury and the involved
- **2. Legal action**
 - Minor damages?
- **3. Settlement / exchange of information**
 - Settle outside the courtroom
 - USA: „pre-trial discovery“
 - Europe: Presentation of evidence
- **4. Bargaining between the parties**
 - Eventually mediation, out-of-court settlement, „ADR“

Stages in a Legal Dispute (3)

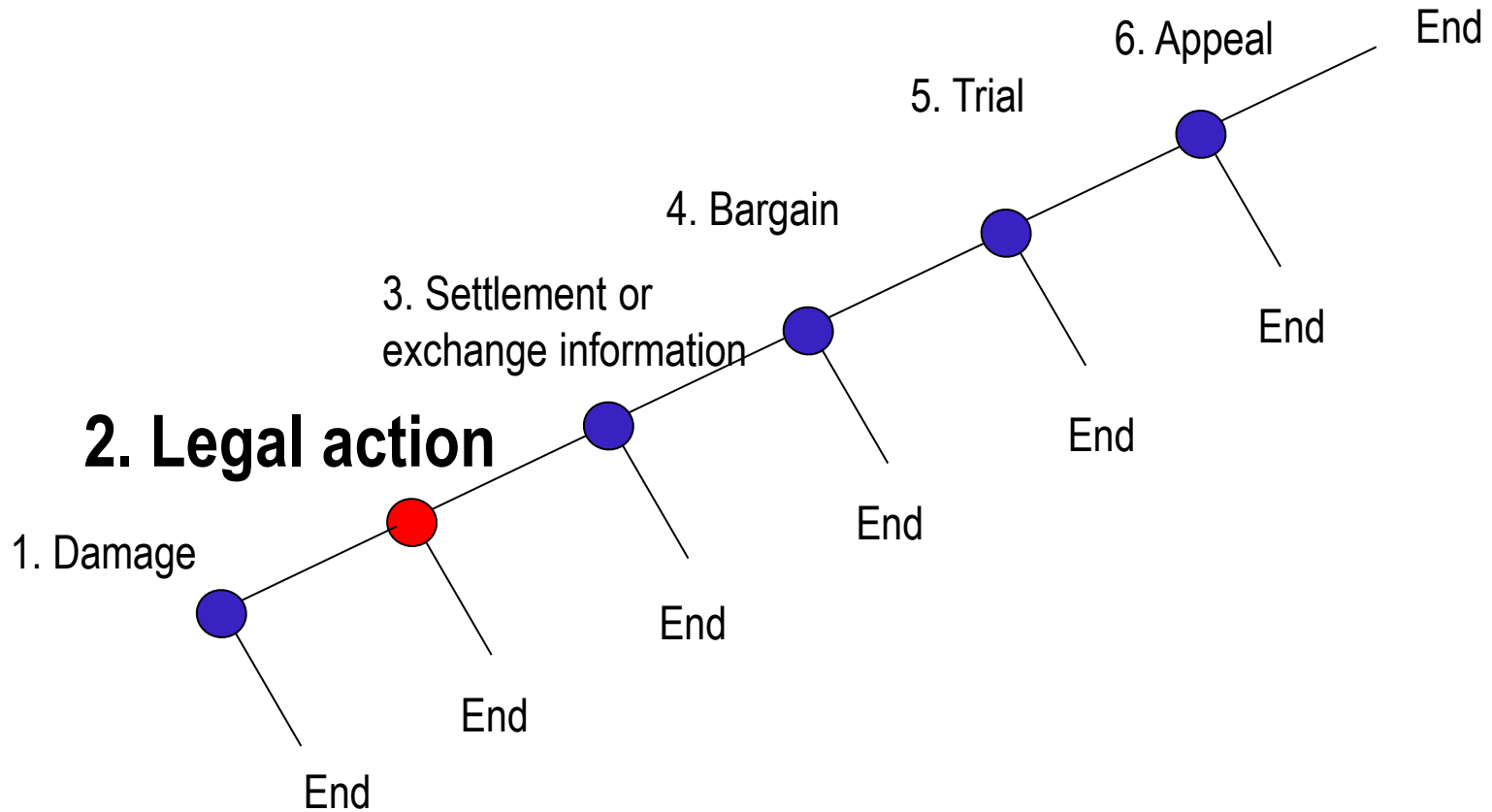
- **5. Trial**
 - Legal costs
 - Fees
 - Lawyers
 - Opportunity costs
 - Who bears the costs
 - „European Rule“: Losing party pays
 - „American Rule“: Each pays his own
- **6. Appeal**
 - Costs?
 - Other decision makers
 - Jury v. judge
 - “moods” of judges?

Stages in a Legal Dispute

Expected Value of a Legal Claim



Stages in a Legal Dispute



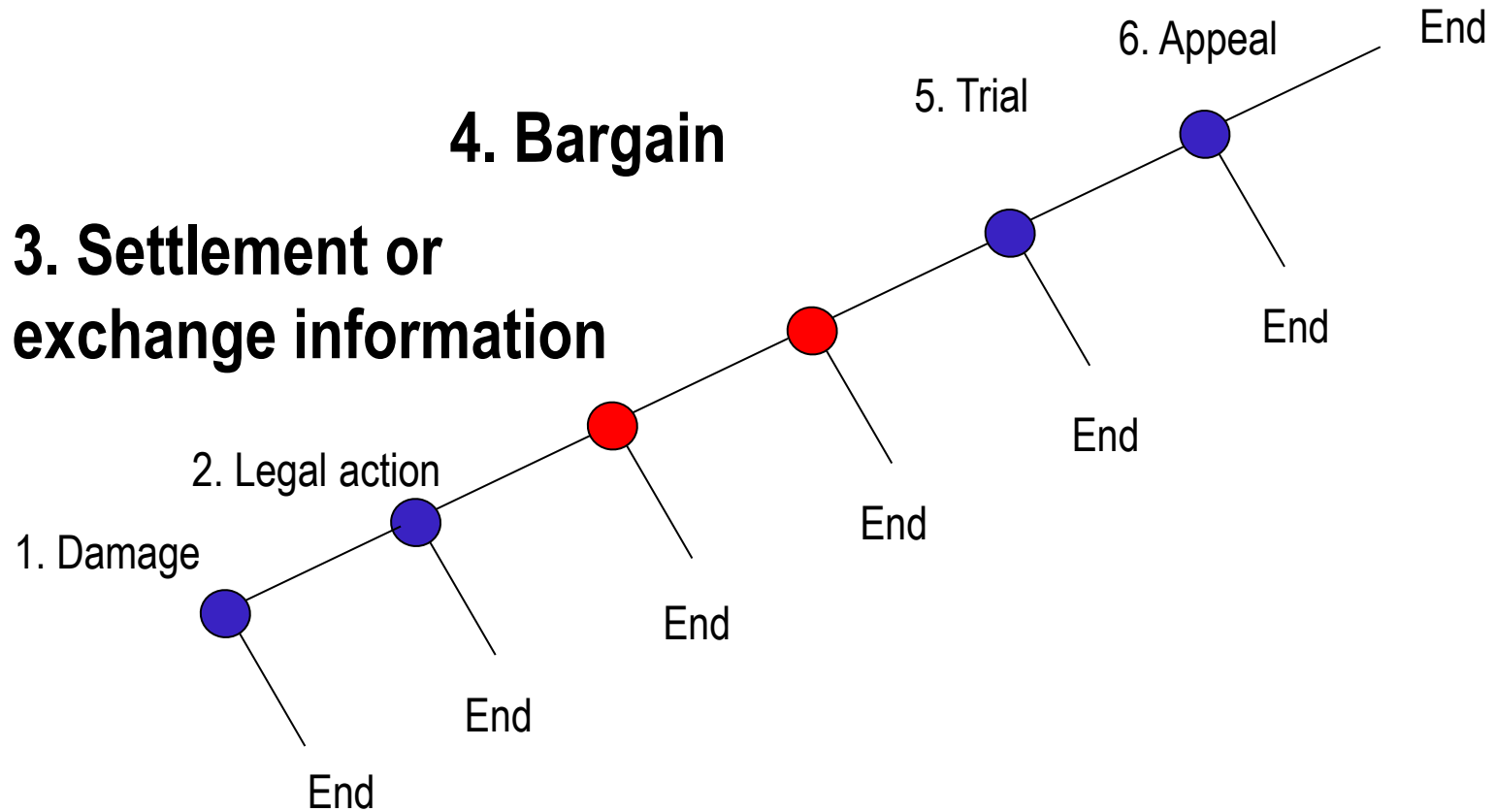
Market for Legal Claims (1)

- **Influencing variables on the market for legal claims**
 - Costs of the legal claim
 - Expected value of the claim
- **(Private) costs of the legal claim**
 - Cost allocation of the courts
 - Who bears the courts fees?
 - Class actions possible?
 - Market for lawyers
 - Price of lawyers' service
 - Number, form of legislation?
 - Agency problems

Market for Legal Claims (2)

- **Expected Compensation**
 - Jury or judge?
 - Punitive damages?
 - USA: „Oh my god“– rule
 - Amorphous system
 - Independence of judges?

Stages in a Legal Dispute



Private and Social Costs

- **Private costs => Expected value of legal claim**
 - Costs v. benefit of the claim
- **Social costs**
 - Costs of courts
 - USA 2002
 - Civil law disputes before the court: 20 million cases
 - Criminal law disputes: 16 million cases
 - USA 1983
 - Civil and criminal law costs 39.7 Bio. \$ = 170 per person
- **Lawyers**
 - 20 times more in US than in Japan
 - 5 times more than in Germany

Claim or Not (1)?

Private v. Social Costs

- **Example: „Small accident“**
 - Strict liability
 - Risk of accident: 10%
 - CHF 10 could reduce the risk of accidents (-9%)
 - Damages of 1'000 CHF
- **Strict liability:**
 - Costs of accident: $1'000 \times 10\% = 100$
 - Costs of caution: $10 + (1'000 \times 1\%) = 20$
- **Tort law provide incentives for optimal caution**

Claim or Not (2)?

Private v. Social Costs

- **Problems of preventive complaint cost**
 - Costs for plaintiff: 3'000 CHF
 - Costs for defendant: 2'000 CHF
- **Example:**
 - Complaint costs = 3'000 < 1'000 => No claim
- **Without claim no incentive for caution!**

Claim or Not (3)?

Private v. Social Costs

■ Accident :

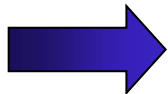
- Social/administrative costs of accident

- $10\% \times 1'000 = 100$

- Social/administrative costs of a claim

- But: $10 + 1\% \times (1'000 + 3'000 + 2'000) = 70$

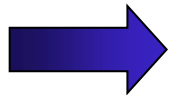
■ Claim is socially desirable



**Tort law loses its incentive component,
because private costs for claim are too high**

Social/Private Costs of a Legal Claim (1)

- **Divergence between social/private desirable claims:**
 - Private person considers only his own costs
 - Disregard of:
 - Costs for the other party
 - Costs of court
 - Precautions, social costs => Incentives for others



Half of the costs of a legal claims are not taken into consideration

Social/Private Costs of a Legal Claim (2)

- **Counter measures**
 - Settlements outside the court
 - Plaintiff pays the court fees
 - Might be counterproductive
 - In which cases?
 - Losing party pays
 - Incentives for claims
 - In which cases?
- **Categorisation would be necessary**

Settlement or Trial?

European v. American Rule

- **American Rule:**
 - Each pays his own costs
- **European Rule:**
 - Loser pays all

Settlement or Trial? (1)

(American Rule)

■ Example

■ Plaintiff:

- Chance of winning 80%, damage 100'000
- Costs 15'000

■ Defendant

- Chance of winning 50%, damage 100'000
- Costs 20'000

■ What happens?

Settlement or Trial? (2)

(American Rule)

■ Example:

■ Plaintiff

- Expected value $80\% \times 100'000 = 80'000$
- $80'000 - 15'000 = \mathbf{65'000}$

■ Defendant

- Expected loss $50\% \times 100'000 = 50'000$
- $70'000 + 20'000 = \mathbf{70'000}$

■ Negotiating range for settlement

- „Threat value“ plaintiff v. defendant

Settlement or Trial? (1)

(European Rule)

- **Example**

- Plaintiff:

- Chance of winning 80%, damage 100'000
 - Costs 15'000

- Defendant

- Chance of winning 50%, damage 100'000
 - Costs 20'000

- **What happens?**

Settlement or Trial? (2)

(European Rule)

■ Example:

■ Plaintiff

- Expected value $80\% \times 100'000 = 80'000$
- Cost risk: $20\% \times 35'000 = 7'000$
- $80'000 - 7'000 = \mathbf{73'000}$

■ Defendant

- Expected loss $50\% \times 100'000 = 50'000$
- Cost risk: $50\% \times 35'000 = 17'500$
- $50'000 + 17'500 = \mathbf{67'500}$

■ No negotiating range for settlement

- „Threat value“ plaintiff v. defendant

Settlement or Trial?

Informations

- **Assessment of the parties**
 - Asymmetric information
 - „Bad news is free“
 - „Good news“ are withheld
 - Relative optimism
- **Judicial system : Information obligations**
 - USA: Pre-trial discovery
 - Exploration of evidence before the case comes to trial
 - Europe:
 - Proof before judge
 - Which rules are more efficient in which cases?
- **Psychology**
 - Willingness to take risks

Settlement or Trial?

Nuisance Suits

- **Claims with low amount of damages**
 - European system
 - Plaintiff $0 - (p) \times 1'000 = X$
 - Defendant $0 + (p) \times 5'000 = X$
 - American system
 - Plaintiff $0 - 1'000 = -1'000$
 - Defendant $0 + 5'000 = 5'000$
- **Do such court cases make sense?**
 - Asymmetric information
 - Higher opportunity costs for the defendant

Social/Private Costs – Settlements (1)

■ Settlement

- Plaintiff saves attorneys' fees
- Again: Disregard of court fees

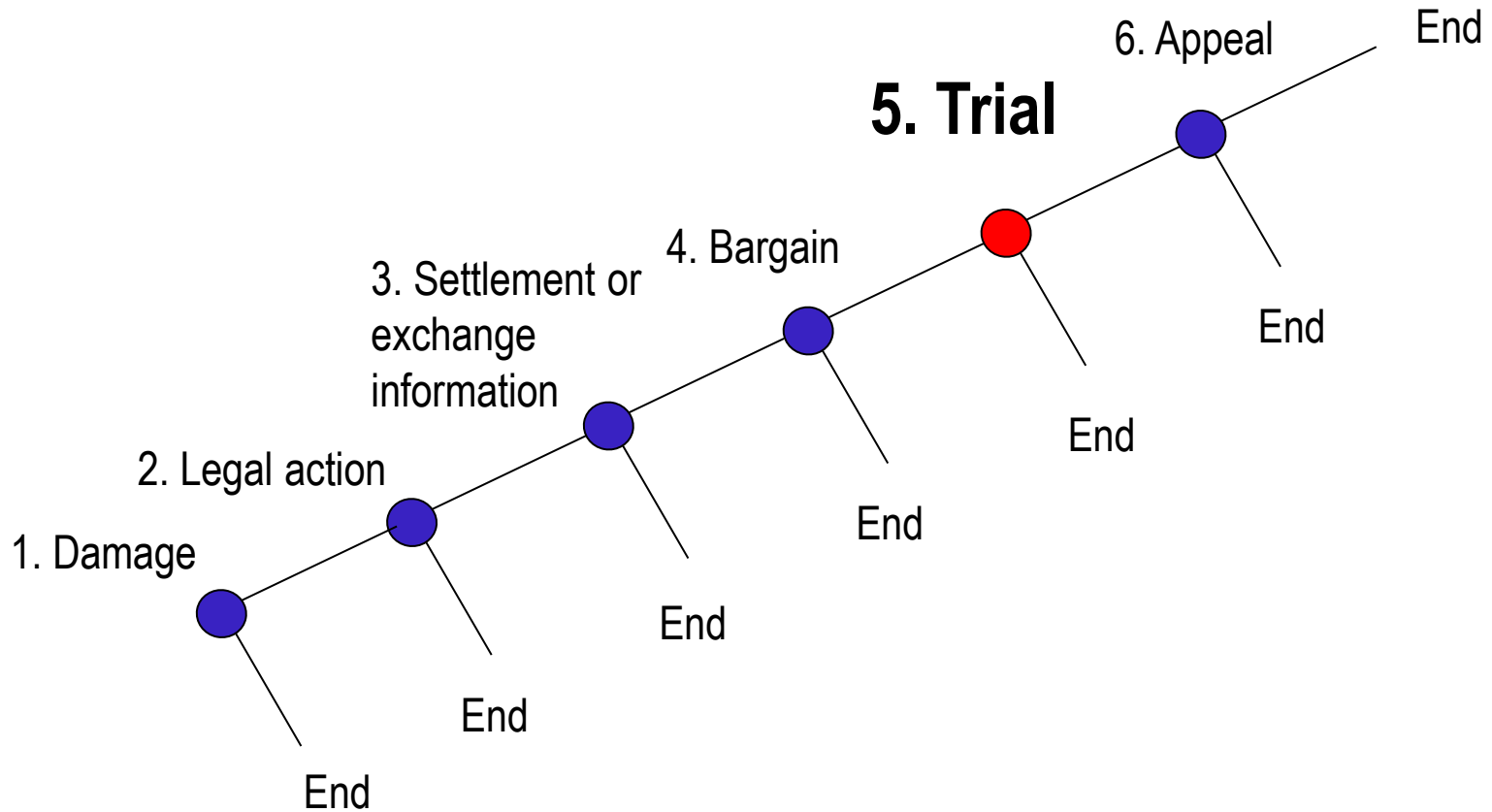
■ Problems:

- Asymmetric information
 - Wrong assumptions lead to undesirable claims or settlements
- Settlement: lack of deterrence

Social/Private Costs – Settlements (2)

- **Influence?**
 - Mediation
 - Exchange of evidence
- **Objective: Lower legal costs**
- **Conclusion:**
 - Trial as a „threat“ to find a settlement and avert social expensive legal procedures

Stages in a Legal Dispute



Trial (1)

- **Private costs**
 - Contradictory arguments
 - „Arms race“, competition
 - Confusing arguments
 - Extend and complicates the legal process
 - Inappropriate arguments
 - „Money goes up in smoke“
- **Equipment of trials**
 - Independency of judges
 - Jury?
- **Evidence procedure**
 - USA: pre trial discovery v. Europe: evidence
 - Burden of evidence, signs, etc.

Trial (2)

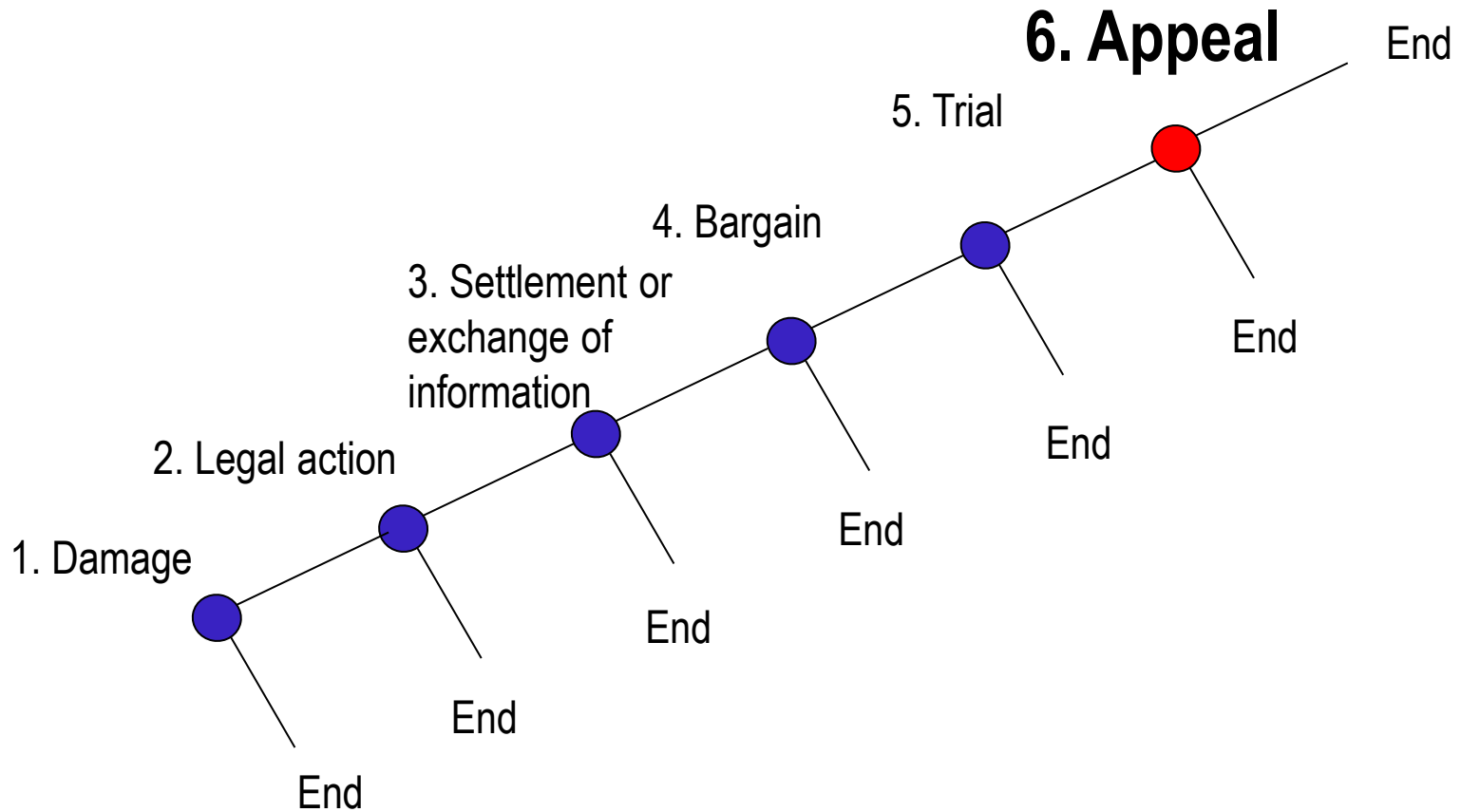
- **Effect of judgement:**

- Compensation/redress
- Deterrence/incentives

- **Problem:**

- Missing incentives
 - Tort: optimal precautions
 - No negligence
 - Compensation is required, legal costs without benefit

Stages in a Legal Dispute



Appeal - Overview

- **Correcting mistakes**
 - Reverse an error (alpha error)
 - Reverse a correct decision (beta error)
- **Efficiency of the litigation market**
- **Enacting social norms**
 - Judge-made law
 - Efficiency as a judicial motive?
 - Redistribution effects v. efficiency effects
- **Problem: Non reversible penalties**
 - Corporal punishment; death penalty
 - Social punishment; reputation effects