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ABOUT US

WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal provide dedicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

WHITE BLACK LEGAL: THE LAW JOURNAL

ECONOMICS IN TRIALS

(Diya Dutta)

INTRODUCTION

For the rational study of the law, the black letterman may be the man of the present, but the man of the future is the man of statistics and the master of economics.

Justice O. W. Holmes (1897)

We had always witnessed a close link between law and economics, be it in antitrust laws or regulating industries, taxes or monetary damages. However, the interaction between law and economics has expanded over the last few decades, where it was seen how the use of economics reached various areas of law, like property, contracts, tort, criminal law, constitutional law and as well as procedural law. It is safe to ascertain that economics has positively affected the nature of legal rules, institutions and even the practice of law. A classical illustration of this is, how by 1990, at least one economist was on the faculty of each of the top law schools in the West and how the increasing development of economics acts as a pivotal part of the legal curriculum depicting nothing but the heavy influence of economics in the field of law.[1] The correlation of economic theories into law has been very convenient due to the structural similarities between the two theories. For instance, the notion of "reasonable man" in law is very similar to the concept of "rational man" in economics, further, the idea of fair division of burden in law is very much congruent to economics' efficient allocation of resources.

In different countries, there are different ways in which a trial is conducted.[2] There are many themes that we come across while discussing the economic approach to such legal procedures. The main problem of this paper shall be to understand the stages of a trial/legal procedures; to check whether the goal of trials is to minimize social costs; to analyze the economic approach specially in terms of property law and contract law; and to have a comparison between settlement bargaining and legal trials.

In the recent years, several economists and lawyers, along with eminent jurists have studied the economic approaches to legal process and trials. Steven Shavell (2003)[3] is one of such authors who has extensively written on the economic analysis of litigation and the legal

[1] *The Economic Analysis of Law.* STANFORD ENCYCLOPAEDIA OF PHILOSOPHY. (July 17, 2017) available at https://plato.stanford.edu/entries/legal-econanalysis/

[2] Antony W. Dnes, *Economic Analysis of Law.* Published by Studying Economics. Available at http://www.studyingeconomics.ac.uk/module-options/economic-analysis-of-law/

[3] Steven Shavell, *Economic Analysis of Litigation and Legal Process*, Harvard Law Review, DISCUSSION PAPER 404 (FEBRUARY, 2003)

process. While he gives basic theory of litigation, such as introducing suits and elucidating on socially desirability of suits, trial expenditure and accuracy of the legal process. Robert Cooter and Thomas Ulen (2016)[4] builds up on their notions of law and economics by emphasizing on the economic theory of property law, tort law, law of contracts and crime & punishment. The authors also describe the concept of settlement bargaining, trials and appeals, in order to give an elaborate understanding of the economic theory of legal process. While discussing the concept of settlement bargaining, the author has also relied upon Ronald H. Coase (1960)[5], in order to understand the problem of social cost and the concept of mutually benefitted agreements. Authors like, William M. Landes & Richard A. Posner (1993)[6] conceptualized the entire idea of the influence that economics has on law, which gave the researcher a strong case to link economics in legal procedures and trials. Daniel L. Rubinfeld and Robert Cooter (1989)[7], in their paper captioned '*Economic Analysis of Legal Dispute and Their Resolution'* also illustrated on the chronology of legal disputes and the behavior of trials through economic variables. Further, Thomas Miceli (2003)[8] defines the model of asymmetric information of trials and settlements, social versus private incentive to sue and the evolutions of law.

The paper shall be organized in five sections. While the first section will introduce the concept of law and economics and give a background of the economic approach that's there in trials and legal processes; section two shall highlight how economics is used in various areas of law, with a special emphasis on property law and law of contract. The third segment shall illustrate the idea of suits, why we sue, and the private and social incentives behind suing. The fourth section will incorporate the concept of settlement bargaining with a subtle focus on Nash equilibria and the Coase theory of social cost and shall elucidate on the trials versus ADR debate. Lastly, the fifth segment, will have the conclusion of the paper, where the researcher shall prove or disprove the hypothesis that, firstly, trials minimizes social costs and secondly, that settlements are economically better than trials.

LAW AND ECONOMICS

The application of economics to law is not confined to those areas of law that directly affect markets or economic activity. It goes well beyond these to examine fundamental legal

[4] Robert Cooter and Thomas Ulen, *Law and Economics*, Berkeley Law Books, 6TH ED. (2016)
[5] Ronald H. Coase, *Problem of Social Cost*, Journal of Law and Economics 3 (October) (1960)
[6] William M. Landes & Richard A. Posner, *The Influence of Economics on Law: A Quantative study*, 36 J. L & ECON 385 (1993)
[7] Daniel L. Rubinfeld and Robert Cooter, *Economic Analysis of Legal Dispute and Their Resolution*, University of California Berkeley, 26 J. E. L, PP- 1067- 1097 (1989)
[8] Thomas J. Miceli, *The Economic Approach to Law*, 3RD ED. (2003)

institutions. The more innovative extension of economics is the so-called economics of law or law-and-economics, which takes as its subject matter the entire legal and regulatory systems irrespective of whether or not the law controls economic relationships. It looks in detail at the effects and the structure of the legal doctrines and remedies that make up existing laws.[9]

Economics provided a scientific theory to predict the effects of legal sanctions on behaviour. To economists, sanctions look like prices, and presumably, people respond to these sanctions much as they respond to prices. People respond to higher prices by consuming less of the more expensive good; presumably, people also respond to more severe legal sanctions by doing less of the sanctioned activity. Economics has mathematically precise theories (price theory and game theory) and empirically sound methods (statistics and econometrics)[10] for analysing the effects of the implicit prices that laws attach to behaviour.

The economic analysis of law unites two great fields and facilitates understanding each of them. You probably think of laws as promoting justice; indeed, many people can think in no other way. Economics conceives of laws as incentives for changing behaviour (implicit prices) and as instruments for policy objectives (efficiency and distribution). However, economic analysis often takes for granted such legal institutions as property and contract, which dramatically affect the economy. Thus, differences in laws cause capital markets to be organized differently in Japan, Germany, and the United States. Failures in financial laws and contracting contributed to the banking collapse of 2008 in the United States and the subsequent recession, which was less severe in Japan and Germany. Also, the absence of secure property and reliable contracts paralyzes the economies of some poor nations. Improving the effectiveness of law in poor countries is important to their economic development. Law needs economics to understand its behavioural consequences, and economics needs law to understand the underpinnings of markets.

Economists and lawyers can also learn techniques from each other. From economists, lawyers can learn quantitative reasoning for making theories and doing empirical research. From lawyers, economists can learn to persuade ordinary people—an art that lawyers continually practice and refine. Lawyers can describe facts and give them names with moral resonance, whereas economists are obtuse to language too often. If economists will listen to what the law has to teach them, they will find their models being drawn closer to what people really care about.

[9] Cento Veljanovski, *The Economics of Law*, THE INSTITUTE OF ECONOMIC AFFAIRS. 2nd ed. (2006)
[10] *Supra* note 4

ECONOMIC THEORY IN TRIALS

This chapter applies economics to the procedural aspects of civil disputes, whereas the preceding chapters applied economics to the substantive law of property, and contracts. The procedural aspects concern the process from the filing of a complaint to the resolution of the dispute through dismissal, settlement, or litigation.

The main aim of any legal process is to minimize the social cost that is there. It becomes immensely crucial for us to understand here, as to, what are social and private cost. While private cost refers to the cost of production incurred and provided for by an individual firm engaged in the production of a commodity, social cost refers to the cost of producing a commodity to the society as a whole.[11] It takes into consideration all those costs, which are borne by the society directly or indirectly; and not just borne by the firm. In furtherance to this, there is another concept, when we speak of the economic analysis of the legal procedure, this is referred as the administrative cost. Administrative costs are the sum of the costs to everyone involved in passing through the stages of a legal dispute, such as the costs of filing a legal claim, exchanging information with the other party, bargaining in an attempt to settle, litigating, and appealing. In addition, the legal process sometimes makes errors in applying substantive law.[12] For example, the wrong party may be held liable, or the right party may be held liable but for the wrong amount. Errors distort incentives and impose a variety of costs on society. While we calculate the social cost, we take into account such administrative cost and cost of errors. The entire economic objective of procedural law is to minimize the sum of administrative costs and error costs.

Most private disputes remain outside the courts. The courts typically get involved when the injured party asks them for a remedy. The filing of a suit marks the beginning of this formal process; filing a complaint creates a legal claim. To decide whether to initiate a suit, a rational plaintiff compares the cost of the complaint and the expected value of the legal claim.

SETTLEMENT BARGAINING

While the paper strives to analyse the economic theory that is involved in trials and court proceedings, what is immensely important to understand is the settlement that is there outside the court as well. All these sort of bargaining can occur at any time in the legal process.

[11] Sam Malhotra, What is the Difference between "Private Cost" and "Social Cost". Share your Essay. Available online at http://www.shareyouressays.com/knowledge/what-is-the-difference-between-private-cost-and-social-cost-explained/115650

[12] *Supra* note 4

Conventionally, the stage of bargaining is placed just before trial for the simple reason being that bargaining acts as an attempt to avoid the usual course of having an expensive and time taking (not-so-economical) legal process.[13] However, bargaining may well continue after a trial has begun and even while the jury is deliberating. Most disputes are resolved without resorting to trial. Bargaining is more important than trials for the resolution of most disputes. However, bargaining occurs in the shadow of the law. In other words, expectations about trials determine the outcomes of bargains.[14]

A. BARGAINING THEORY

Economists are interested in bargaining not merely because many transactions are negotiated (as opposed to being entirely determined by market forces) but also because, conceptually, bargaining is precisely the opposite of the idealized "perfect competition" among infinitely many traders, in terms of which economists often think about markets. Bargaining situations concern as few as two individuals, who may try to reach agreement on any of a range of transactions which leave them both at least as well off as they could be if they reached no agreement.[15] To understand the bargaining theory better, below is the theories given by two very eminent philosophers in brief:

i. Nash Equilibria

John Forbes Nash Jr. was an American mathematician who made fundamental contributions to game theory, and provided insight into the factors that govern chance and decision-making inside complex systems found in everyday life. In his 1950 paper he proposed a model which predicted an outcome of bargaining based only on information about each bargainer's preferences, as modelled by an expected utility function over the set of feasible agreements and the outcome which would result in case of disagreement.[16] In his 1953 paper Nash considered a simple model of the strategic choices facing bargainers, and argued that one of the strategic equilibria of this game,[17] which corresponded to the outcome identified in his 1950 paper, was particularly robust. Nash's approach of analyzing bargaining with complementary models focus on outcomes, in the spirit of "cooperative" game theory, and more detailed strategic models. One direction this work has taken has been to connect bargaining theory with the theory of

[13] Robert Cooter and Thomas Ulen, *Law and Economics*, Berkeley Law Books, 6TH ED. (2016)
[14] Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 40, 44 (1983).
[15] Alvin E. Roth, *Economic theories of Bargaining,* Stanford Publications.
[16] Nash, John [1950], *The Bargaining Problem*, Econometrica, 18, 155- 162.

[17] Nash, John [1953], *Two-Person Cooperative Games*, Econometrica, 21, 128-40.

competitive equilibrium in markets, by examining market models in which agents meet and negotiate transactions, with the option of returning to the market in case of disagreement.[18]

ii. Coase Theorem

Ronald Coase received the Nobel Prize in 1991 for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy.[19] His pathbreaking article on 'The Problem of Social Cost' largely gave rise to the field called law and economics. Economists before Coase of virtually all political persuasions had accepted British economist Arthur Pigou's idea that if, say, a cattle rancher's cows destroy his neighbouring farmer's crops, the government should stop the rancher from letting his cattle roam free or should at least tax him for doing so. Otherwise, believed economists, the cattle would continue to destroy crops because the rancher would have no incentive to stop them. However, Coase challenged this conventional view and pointed out that if the rancher had no legal liability for destroying the farmer's crops, and if transaction costs were zero, the farmer could come to a *mutually beneficial agreement* with the rancher under which the farmer paid the rancher to cut back on his herd of cattle.[20]

ANALYSIS:

If we try to understand conceptually what Nash and Coase directed towards, then we will understand that what both of them encouraged was bargaining settlements and not the legal procedures so much. Finding a middle ground and having a mutually beneficial agreement is any day more economical than having an issue litigated. As also illustrated by Coase also, that holding one party liable and penalising them will lead to minimisation of the social cost.

B. INTRODUCTION OF ADR

Alternative Dispute Resolution, popularly known as 'ADR', is a method by which legal conflicts and disputes are resolved privately and other than through litigation in the public courts. There were many problems that one faced in cases of trials. Trials were very expensive in terms of its cost, and here the ambit of 'cost' expands in three-folds. Firstly, the cost in the purest monetary terms refer to the high fees that goes behind in such legal proceedings. Lawyers command high fees in many countries, partly because of the bar's monopoly power,

[18] Binmore, Ken and Partha Dasgupta, *The Economics of Bargaining*, Blackwell, Oxford.

[19] R. H. Coase *Business Organization and the Accountant*. *L.S.E. Essays on Cost.* London: Weidenfeld and Nicolson, 1973.

[20] Ronald H. Coase, *Problem of Social Cost*, Journal of Law and Economics 3 (October) (1960)

its specialized training and licensure, and its privileged access to legal officials. Legal fees increase further where corruption makes bribery a routine part of the legal process. Secondly, the parties to a case pay in terms of the unnecessary time that goes behind the delayed procedure. Lastly, the major reason as to why trials have grown popular off late, is the lack of clarity in law and uncertainty about how a court might resolve an issue imposes unpredictable costs on people caught in legal disputes. This is precisely why ADR was introduced, with a hope to mitigate such shortcoming of legal proceedings.

A brief description of few widely used ADR procedures is as follows:[21]

1. **Negotiation:** A non-binding procedure in which discussions between the parties are initiated without the intervention of any third party, with the object of arriving at a negotiated settlement of the dispute.
2. **Conciliation:** In this case, parties submit to the advice of a conciliator, who talks to the each of them separately and tries to resolve their disputes. Conciliation is a non-binding procedure in which the conciliator assists the parties to a dispute to arrive at a mutually satisfactory and agreed settlement of the dispute.
3. **Mediation:** A non-binding procedure in which an impartial third party known as a mediator tries to facilitate the resolution process but he cannot impose the resolution, and the parties are free to decide according to their convenience and terms.
4. **Arbitration:** It is a method of resolution of disputes outside the court, wherein the parties refer the dispute to one or more persons appointed as an arbitrator(s) who reviews the case and imposes a decision that is legally binding on both parties. Usually, the arbitration clauses are mentioned in commercial agreements wherein the parties agree to resort to an arbitration process in case of disputes that may arise in future regarding the contract terms and conditions.

C. OUT OF COURT SETTLEMENTS IN INDIA

An out-of-court settlement occurs when the two parties make an agreement on any claim without having a judge come to a decision in the case. A survey by non-profit organisation Daksh reveals that most people don't prefer police and lawyers in case of a dispute. Of the 45,500 people surveyed in 28 states, 74% prefer out of court settlements.[22] In India particularly,

[21] Vinay Vaish, *Alternative Dispute Resolution in India*, Vaish Associates. Mondaq. (11 December 2017)
[22] Sahil Makkar, *Only 9% people approach police, 74% prefer out of court settlement*. Business Standard. (January 25, 2018)

the idea of out of court settlements have grown immensely popular recently. Section 89 of the CPC validates out of court settlement through the means of Alternative Dispute Resolution Mechanism. Mediation, Conciliation, Lok Adalats are the new tools of the justice dispensing system.[23] Order 23 Rule 1 of CPC talks of withdrawal of suit or a part of the claim in a suit, therefore, the order of CPC discusses out of court settlement without naming it.

The term 'Collective Bargaining' is to be understood by its etymological sense. Lengthy court procedure is not a solution nowadays. In cases of industrial disputes, both, the management as well as the workers are not in favour of lockouts or strikes. The Industrial sector depends on manpower and labour. An alternative to court procedure is the option of 'Collective Bargaining'. Under Section 18 (1) of Industrial Dispute Act, 1947, a settlement arrived at by an agreement between the employer and workmen otherwise than in the course of conciliation proceedings is binding only on the parties to the agreement.[24] Further, cases relating to property disputes usually take years to settle. Therefore, an alternative of mediation is always available to settle the dispute. This is a form of out of court settlement the only condition is, all the parties to the dispute must agree to out of court settlement.[25] Similarly, in claims of 'motor accidents through compromise', there is the *Jald Rahat Yojana* which facilitates out of court settlements. Lastly, even in the Act of Sexual Harassment at Workplace, section 10 talks about 'Conciliation' as a method to resolve any conflict.

CONCLUSION

Trials are very expensive everywhere. Such litigation falls uneconomical as the Fees are usually higher partly because of the bar's monopoly power, its specialized training and licensure, and its privileged access to legal officials. Further, such litigative processes bore extensive amount of delays, for instance, resolving a court case in India can take a decade and in the United States it takes around three years to bring a case to the Superior Court. Lastly, there exists lack of clarity in law and uncertainty about how a court might resolve an issue imposes unpredictable costs on people caught in legal disputes. Given these costs, being drawn into a legal suit is a punishment in itself for the parties.

To avoid this punishment, many lawyers earn their living by keeping people out of legal disputes. The specified procedures characteristically bypass the public courts and substitute streamlined alternatives. The alternative procedures have the name "alternative dispute

[23] *Salem Advocate Bar Association v. Union of India*, AIR 2003 SC 189

[24] Marysur, *Collective Bargaining,* 1965, p.4.

[25] Anubhav Pandey, *How to settle a case out of Court?* iPleaders. August 13, 2017.

resolution" or ADR, which includes various types of mediation, arbitration, et al. The contract, for example, may call for resolving any dispute by arbitration in a particular city, following the rules of a particular arbitration association. This paper aimed at proving how economics in trials works, and as depicted above, trials do not minimise the social cost of an individual. Further, when bargaining theory comes into play we observed that ADR is a more feasible and economical option to resolve such legal disputes.