

## Chapter 9

### The Economics of Legal Procedure

This chapter examines the economics of legal procedure, including both civil and criminal procedure. The focus is on how procedural rules affect the cost of dispute resolution, and how legal procedure generally contributes to the efficient functioning of the law.

#### Key Points

- Economists are concerned with the process of dispute resolution because litigation is costly, and economic theory may suggest ways to lower this cost.
- The litigation process determines how the common law evolves because only those disputes that come before the courts can affect legal change.
- Plaintiffs and defendants have a common interest in resolving their disputes out of court so as to avoid the costs of trial. Consistent with this prediction, the vast majority of disputes settle out of court. The key question then becomes: why do any cases go to trial?
- The differing perceptions, or optimism, model of dispute resolution says that trials occur when plaintiffs and defendants are mutually optimistic about the outcome of a trial. This model predicts that trials become more likely as the costs of a trial decrease and as the stakes of a trial increase.
- The asymmetric information model of trials says that trials can result when one party to the dispute holds private information about his or her prospects at trial. This model yields the same basic predictions regarding when a trial is more likely to occur.
- Two other factors affecting the settlement-trial decision are the risk preferences of litigants, and the possibility of asymmetric stakes at trial (for example, if one party is a repeat player).
- Placing the burden of proof on plaintiffs discourages plaintiffs from filing meritless claims.
- The process of pretrial discovery can promote settlement by reducing disagreement and/or asymmetric information prior to trial. However, it can also lead to abuse by allowing one side to impose high costs on the other.
- The English, or loser-pays, rule requires the loser at trial to pay the winner's litigation costs. Switching to this rule has an ambiguous effect on settlement: whereas it reduces the likelihood of settlement by raising the stakes at trial, it increases the likelihood of settlement by increasing the riskiness of trial.

- The English rule discourages the filing of low quality suits, and encourages the filing of high quality suits. Empirical and experimental evidence generally supports the theoretical predictions regarding the impact of the English rule.
- Rule 68 shifts the defendant's trial costs to the plaintiff if the plaintiff rejects a settlement offer and then receives a lower judgment at trial. Theory predicts that this rule should promote settlement by expanding the settlement range.
- The most common form of compensation for plaintiffs' lawyers in tort suits is a contingent fee, under which the plaintiff pays the lawyer a fixed percentage of his or her recovery.
- Contingent fees provide lawyers an incentive to work hard for the client by giving them a stake in the outcome of the case. However, they may distort the settlement-trial decision by encouraging too many settlements and may promote frivolous suits.
- Frivolous suits, or suits lacking legal merit, may succeed in eliciting a settlement if defendants are uncertain about the probability of plaintiff victory at trial (as in the asymmetric information model), and if the fraction of frivolous claims is small.
- Court delay is an important problem in the dispute resolution process. Defendants may be able to use delay strategically to lower their costs by sorting plaintiffs according to their time discount rates.
- The standard of proof in a legal proceeding is optimally chosen to minimize the expected cost of legal error. Specifically, the optimal standard of proof balances the costs of false convictions (type I errors) and false acquittals (type II errors). The higher standard of proof in criminal trials as compared to civil trials reflects the higher cost of false convictions in criminal cases.
- The social value of a lawsuit is its ability to induce potential injurers to take cost-effective care, while the private value is the gain the plaintiff expects at trial minus the filing cost. Generally, these two values will not coincide. As a result, there may be too many or too few suits from a social perspective.
- An important conjecture in the economic analysis of law is that the common evolves toward efficiency. The question of which disputes go to trial is important in evaluating this claim because only those disputes that make it to trial can affect the direction of legal change.
- Two conditions are sufficient for the law to evolve toward efficiency. First, inefficient laws are more likely to be litigated than efficient laws. Second, judges are not biased against efficiency.
- Judges often decide cases by following precedent—that is, by invoking a ruling from a past, similar case. This is an efficient way to make decisions under uncertainty if decision costs and the likelihood of judicial error are high. However, it may impede the evolution of the law by entrenching inefficient rules.

- Judges may affect the direction of legal change by seeking to impart their own biases onto the law. Precedent and selective litigation (the fact that inefficient laws disproportionately go to trial) mitigate the potentially detrimental effects of judicial bias on efficiency.
- Plea bargaining—the admission of guilt by a criminal defendant in return for a reduced sentence—is the means by which the vast majority of criminal convictions are obtained. Economic models of plea bargaining are similar to settlement models of civil litigation, except that the prosecutor, representing the state, takes the role of the plaintiff.
- Plea bargaining places considerable power to determine criminal sentences in the hands of prosecutors. To the extent that prosecutors pursue ex post proportional punishments, the process of plea bargaining represents an institutional impediment to the low probability-high penalty punishment scheme prescribed by the economic model of crime.
- In contrast to the United States, European countries have historically discouraged the use of plea bargaining. European trials, however, tend to be less costly than American trials and offer defendants fewer procedural protections.
- The bail system is designed to balance the benefit of allowing criminal defendants to remain free prior to trial (given the presumption of innocence) against the risk that they will flee and possibly commit further crimes. The optimal bail is therefore increasing in the likelihood that the defendant will flee.
- Enactment of sentencing guidelines in the 1970s and 80s curtailed the discretion of judges in imposing criminal sentences. One goal of the reform was to eliminate unwarranted disparities in sentences for offenders convicted of the same crime; another was to stiffen sentences in order to enhance deterrence.
- Empirical evidence is mixed regarding whether the guidelines eliminated disparities in sentencing. As for deterrence, there is some evidence that state-imposed guidelines have actually caused the crime rate to increase.
- The Fifth Amendment protects a criminal defendant's right against self-incrimination. An economic analysis suggests that the right to remain silent actually helps to make an innocent defendant's protestations of his innocence more believable.
- The Fourth Amendment protects people against unreasonable searches and seizures. The law enforces this right by disallowing use of evidence obtained in an illegal search (the exclusionary rule). Some scholars, however, have proposed tort liability for unreasonable searches as an alternative remedy.