



Tort law and probabilistic litigation: How to apply multipliers to address the problem of negative value suits

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ABSTRACT

This article advances a proposal that increases access to justice for valuable lawsuits that are currently discouraged by litigation costs. Our proposal converts claims with negative expected values into positive expected value claims by implementing a novel system involving flexible conditional multipliers. Our proposal has two components. First, under the proposed system a plaintiff is allowed to select a damage multiplier that determines the amount of damages the plaintiff receives if the litigation is successful. Second, courts select cases for litigation randomly with a probability inverse to the multiplier selected by the plaintiff.

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1. Introduction

Frivolous lawsuits, punitive damage awards, and large jury verdicts create the perception that society is excessively litigious.¹ Recent theoretical and empirical evidence suggest, however, that the increased complexity and costs of litigation may deter the pursuit of meritorious claims in various areas of law.² Instances in which litigation costs outweigh the expected benefits of trial are no longer the exclusive territory of small claim disputes. High cost-to-value litigation ratios are now common in patent law,³ corporate law, and mass tort disputes, among others.⁴

The possibility of suboptimal levels of litigation raises a number of concerns. Standard models of litigation predict that a plaintiff will file a lawsuit only if the expected benefits of a trial outweigh the expected costs. If the litigation costs outweigh the expected benefits of trial, a potential plaintiff will not file a lawsuit, even if the probability of winning is high. Consequently, if too few claims are pursued in court the deterrent effect of the legal system is under-

mined. For instance, if there is no credible threat of facing financial repercussions, too few potential tortfeasors invest adequately in precaution, leading to higher overall accident rates.⁵ Especially if tortfeasors are in a position to prevent certain accident losses at low costs, the absence of a reasonable expectation of facing a lawsuit is problematic. In such circumstances, creating positive value suits can lead to substantial welfare gains.

This article seeks to resolve the issue of suboptimal levels of litigation by implementing a novel system of litigation. Our proposal has two components. First, we propose that a plaintiff is allowed to select a damage multiplier that determines the amount of damages he or she will receive if the litigation is successful. Second, we propose that courts randomly select cases for litigation with a probability inverse to the multiplier the plaintiff selected. In essence, this proposal introduces a flexible damage multiplier that inversely affects the probability of adjudication.

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¹ See, e.g. Galanter (1983), Barnes (1993).

² See Hylton (1991, 2002), Hersch and Viscusi (2007).

³ Landes (2004), Simensky and Osterberg (1991).

⁴ Burbank (1987), Hensler et al. (2005), Kakalik, Ebener, Felstiner, Haggstrom, and Shanley (1998).

⁵ An inadequate amount of lawsuits may occur because a plaintiff does not adequately take into account the positive effect of his lawsuit on the deterrent function of the tort system. This problem will be acute when the social benefits of a lawsuit outweigh the private gains of the plaintiff (Shavell, 1982). A RAND study estimates that only 1 in 10 injuries result in attempts to collect liability compensation. See Hensler et al. (2005). Note that, because of the additional costs of litigation, proposals to stimulate legal claims do not necessarily increase social welfare overall. See Shavell (1982) (explaining the misalignment between private and social incentives to bring lawsuits).

The advantages of the proposal are threefold. First, by reducing the costs of litigation relative to the gains, a multiplier creates a credible threat to sue for some individuals that would otherwise not pursue claims that have substantial merit. Consequently, the deterrent function of the legal system is improved. Second, the proposal reaches this objective without inducing excessive precautions. Because the random element of adjudication is set off against the increased damages of the multiplier, the expected loss of a suit remains more or less equal for the defendant.⁶ Third, the proposed system has the advantage of providing plaintiffs the opportunity to self-select the optimal multiplier. The optimal multiplier may strongly differ from plaintiff to plaintiff, depending inter alia on varying risk attitudes and differences in litigation costs between the plaintiff and defendant in a dispute (see Section 5 below).

A potential downside of our proposal is that, by converting claims with negative expected values into positive expected value claims, litigation costs may increase. However, the potential increase in litigation costs is mitigated, to some degree, by the fact that our mechanism eliminates a fraction of the claims that are currently filed. Also, the increased level of deterrence should reduce the overall accident rate. Finally, in order to further mitigate increased litigation costs and reduce the amount of weak and frivolous claims, we consider including a maximum multiplier in the proposed system.

We proceed as follows. Section 2 describes the proposal and outlines the main effects. Section 3 contains a formal exposition of our proposal. Section 4 discusses a number of possible objections to our proposal and suggests some possible modifications to the proposal. Section 5 compares the advantages and disadvantages of our system to two alternative systems involving multipliers. Section 6 concludes.

2. Proposal

Our proposed system of probabilistic litigation consists of two steps. First, under the litigation model, a plaintiff is allowed to select a damage multiplier that determines the amount of damages he or she will receive if the litigation is successful. Second, courts randomly select cases for litigation with a probability inverse to the multiplier the plaintiff selected.

To explain the mechanism and effects of this model of litigation, consider the following numerical example. Suppose there are two groups of victims seeking compensatory damages for accident losses. Victims in Group 1 face trial costs of \$50, while victims in Group 2 would incur \$100 in trial costs. The following conditions apply to both groups: (1) all victims have suffered a compensable harm of \$100, (2) all victims have a 70% probability of obtaining compensation in trial (assume further that the plaintiff and defendant share this estimate), (3) the trial costs for the defendant are \$50, and finally (4) each litigant bears his or her own trial costs, as is the case under the American rule. Accordingly, victims in Group 1 will have a credible threat to litigate: the expected value of trial is positive ($0.7 \times \$100 - \$50 = \$20$). Victims in Group 2 will not go to trial: the expected value of litigation is negative for this group ($0.7 \times \$100 - \$100 = -\$30$). Although victims in both groups have a meritorious claim (70% chance of success in litigation), only the first group has a credible threat to litigate. As a result, only potential plaintiffs in Group 1 are likely to receive a settlement offer.

By contrast, under our proposed model of litigation, victims in both groups have a credible threat to litigate. The mechanism works as follows: first, a plaintiff is allowed to select a damage multiplier which determines the amount of damages he or she will receive in case of successful litigation. For example, if the victim selects a multiplier of 3, he or she will not receive \$100 but \$300. Second, a victim is only allowed to bring the case to trial with a probability that equals the (multiplicative) inverse of the selected multiplier. In our example, the victim will have a 33.3% ($1/3$) chance that the case will be allowed to proceed to trial. Thus, there is a probability of 66.6% that the case will not be selected for adjudication. Returning to the example above, note that Group 2 will be offered a positive settlement amount under our proposal if they select a multiplier of 3. Consider also that the settlement amount approximates the expected judgment (\$70). The expected value of trial in Group 2 thus increases from $-\$30$ to $\$36.67$ ($1/3 \times (0.7 \times \$300 - 100)$), with a $1/3$ probability that the case will go to court. In that case, the victim has a 70% chance of obtaining \$300 (3×100) while incurring trial costs of \$100. However, there is a $2/3$ probability that the plaintiff will not be allowed to pursue his claim in court. In that event, the plaintiff is left empty-handed. Meanwhile, the defendant's expected losses under our system equal $\$86.67$ ($1/3 \times (0.7 \times \$300 + \$50)$) when faced with plaintiffs from Group 2. If the parties divide the settlement surplus equally, a victim in this group will likely receive a settlement amount of \$61.67.

For an intuitive explanation of our proposal, consider how the plaintiffs' expected benefits of the litigation remain identical, irrespective of the magnitude of the damage multiplier selected by the plaintiff. This is because the selected multiplier and the inverse probability of trial have a canceling effect. In the example above, if the plaintiff selects a multiplier of 3, the expected benefit equals \$70 ($1/3 \times 0.7 \times \300). If the plaintiff selects a multiplier of 5, the expected benefits remain at \$70 ($1/5 \times 0.7 \times \500). At the same time, while the expected benefits remain at the same level, the expected costs of litigation decrease with relative increases of the selected damage multiplier. Higher multipliers reduce the probability that the case will be selected for litigation and, consequently, that trial costs will be incurred. In the absence of a damage multiplier, the expected cost of litigation is \$100 for the plaintiff. With a damage multiplier of 3, litigation costs are adjusted by the reduced (33.3%) probability of the claim being selected for litigation, reducing the (expected) costs to $\$33.33$ ($100/3$). If the plaintiff selects a multiplier of 10, the expected costs are further reduced to $\$10$ ($100/10$). In summary, the combination of a damage multiplier and an inversely related probability of adjudication does not affect the benefits of litigation, yet it decreases the costs thereof. Thus, the overall effect is an increase in the expected value of the plaintiff's claim. Larger multipliers lead to higher expected values of trial because they lower the expected trial costs. Overall, our proposal brings to life legal actions that have merit, which would normally be deterred because of the prohibitive costs relative to the potential gains.

At first glance, one may fear that this system will be detrimental to potential tortfeasors, prompting them to take excessive precautionary measures in order to prevent liability. Indeed, injurers may ultimately be held liable for amounts that exceed the actual harm for which they are responsible. Note, however, that the opportunity to litigate is limited to a probability that is inversely related to the damage multiplier. For example, even if the plaintiff selects a multiplier of 5, the expected loss for the defendant "merely" equals $\$80$ ($1/5 \times (0.7 \times 500 + 50)$). If the plaintiff has a positive expected value claim to begin with, then the expected loss of the defendant would have been greater without the application of a multiplier: $0.7 \times 100 + 50 = \$120$. Also, it is important to recognize that most parties will settle prior to the selection of a multiplier.

⁶ This stands in contrast to systems of "pure multipliers" that do not randomize litigation. In a pure multiplier system, there is a risk that the multiplier will be set either too low (leading to inadequate precautions) or too high (leading to excessive precautions). A multiplier that brings about first-best deterrence must be chosen by striking a balance between the supply of lawsuits and the need to internalize costs. See *Hylton and Miceli (2005)*.

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