The Law, Economics and Behavior of Class Actions
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Relationship between the Law & the Real World: three waves

• Traditional Law: intuitive (“Old Law & Economics”)

• “Classical” (or “Neoclassical”) “New” Law & Economics: systematic (rationality)

• Law, Economics & Behavior: systematic (open?)
“New” Law & Economics (since 1960)

Approach-based extent:
L&E viewpoint on Economic Law + Non-economic Law

The Law
Law & Economics deals with much more than money issues...
Law & Economics: models as “maps”
Law & Economics is not an ideology

Marx
Efficiency as a Law’s goal (but not the only one)

Efficiency as the *only* or the *main* aim of Law or public policy

Vs.

Analysis of predictable factual consequences of norms and their consistency with *any* aim whatsoever.
“...it is hard to hold that consequences do not matter to the Law. Hence, perhaps a denomination like “Law & Consequences” would have had a more amiable reception in Latin America (and Europe) than “Law & Economics”...”

(Introduction to Economic Analysis of Law, Cooter, R & Acciarri, H., 2012)
Efficiency criteria

• Pareto
  o *Pareto improvement* $\rightarrow$ *Pareto superiority*
  o *Pareto optimality*

• Pareto potential criteria (Kaldor-Hicks)

(Pre-condition: individuals are the *best judges of their own welfare*; “right of veto” if they feel worse off)
Coase’s ideas

An exercise on “Sturges v Bridgman“ (1879, LR 11 Ch D 852)

Defendant: a confectioner in Wigmore Street. The Plaintiff: a doctor, is the occupier of a house in Wimpole Street, which until recently had a garden at the rear, the wall of which garden was a party-wall between the Plaintiff’s and the Defendant’s premises and formed the back wall of the Defendant’s kitchen.
## Outcomes

<table>
<thead>
<tr>
<th>Without transaction costs</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability</td>
<td>Doctor</td>
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<tr>
<td>No liability (no Law)</td>
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A theory of human behavior

- Sistem 1, Sistem 2
- Bias & heuristics
- Choice architecture
- Libertarian Paternalism
- Nudge
¿What is a nudge?

“...A nudge, as we will use the term, is any aspect of the choice architecture that alters people’s behavior in a predictable way without forbidding any options or significantly changing their economic incentives. To count as a mere nudge, the intervention must be easy and cheap to avoid. Nudges are not mandates. Putting fruit at eye level counts as a nudge. Banning junk food does not...” (Thaler & Sunstein, 2008)
Class actions
"Alternative models of res judicata in class actions. A comparative law & economics approach" Hugo Acciarri and María José Azar-Baud, European Journal of Consumer Law, 2016-1, ps. 5 a 33, ISSN 0775-3209.

Rational litigation in single party tort suits

\[ \pi = \text{probability of success of the plaintiff's in claim } f \]
\[ h = \text{value of damages if the plaintiff succeeds in her claim} \]
\[ c_p(f) \text{ and } c_d(f) = \text{administrative cost of the suit for the plaintiff for the defendant}. \]

Plaintiff’s expected value of the suit \( EVf_p = \pi h - c_p(f) \)

Defendant’s expected value of the suit \( EVf_d = -[\pi h + C_d(f)] \)
Rational litigation:  
Class actions (plaintiff)

Class actions turn individual claims into a set of claims to be entertained accumulated, being

- $F$: a class lawsuit encompassing claims for the set $H$ of individual instances of harm $h$, such as $h \in H$.
- Every $h$ can be also claimed by means of an individual lawsuit $f$ which correlates with an administrative cost $c(f)$.
- $F = \{f: f \text{ corresponds to a } h \in H\}$. 
Rational litigation:  
Class actions (plaintiff)  

Economies of scale turn administrative cost of plaintiffs’ claims

\[ C_p(F) < \sum_{f \in F} c_p(f) \] (i.e., a strictly subadditive function)

Differential cost is enough to make the litigation rational, and to “force” the tortfeasor to internalize the full cost of his or her activity.
No “second chance right” and defendant’s costs in the USA

\[ EVh = 0 - \frac{1}{2} \times $1,000 = -$500 \]
“Second Chance Right” and Defendant´s costs

\[ EVh = \frac{1}{2}(-1000) + \frac{1}{2}\frac{1}{2}(1-p)(-1000) = -500 - \frac{1}{4}(1-p)1000 = -500 - 250(1-p) \]

Outcome with second chance: \(-500 - 250(1-p)\)  More costly for the defendant than  \(-500\)

Outcome without second chance:  \(-500\)