

Econ 522 Review 3: Tort Law, Criminal Law, and the Legal Process

Spring 2014

This document is by no means comprehensive, but instead serves as a rough guide to the material we have discussed on tort law, criminal law, and the legal process. I would suggest that you use other study aids as well (such as the lecture slides, discussion handouts, textbook, and exams from previous semesters) in your study for the final.

1 Tort Law

- In contract law, we studied situations where people reach an agreement in advance, and then one harms another by breaking the agreement.
- But in tort law, we study situations where people can't reach agreements in advance, and then one harms another without having made any agreement.
- Tort law mainly covers accidental harm, and seeks to achieve the efficient number of accidents.

1.1 Terminology

- The *plaintiff* is the person who brings the lawsuit (the victim)
- The *defendant* is the person who is being sued (the injurer)
- *Precaution* is any step that can be taken beforehand to reduce the risk of an accident

1.2 Classic Theory of Torts

In the classical theory of torts, either two or three elements must be present for there to be a tort:

- Harm—the plaintiff needs to have been harmed
- Causation—the defendant needs to have caused the harm to the plaintiff
- Breach of Duty—the defendant needs to have failed to take the required standard of care (required only with a negligence rule)

Liability rules with perfectly calibrated compensation and standard of care

Liability Rule	Precaution		Activity	
	Injurer	Victim	Injurer	Victim
No Liability	None	Efficient	Too High	Efficient
Strict Liability	Efficient	None	Efficient	Too high
Simple Negligence	Efficient	Efficient	Too High	Efficient
Comparative Negligence	Efficient	Efficient	Too High	Efficient
Simple Negligence with Defense of Contributory Negligence	Efficient	Efficient	Too High	Efficient
Strict Liability with Defense of Contributory Negligence	Efficient	Efficient	Efficient	Too High

1.3 Tort Liability Rules

- No Liability—the injurer is never liable
- Strict Liability—the injurer is always liable
- Simple Negligence—the injurer is only liable if he or she did not take the required standard of care
- Comparative Negligence—like simple negligence but if both parties are negligent then damages are less than if only the injurer is negligent
- Simple Negligence with Defense of Contributory Negligence—if both parties are negligent, damages are zero
- Strict Liability with Defense of Contributory Negligence—the injurer is only liable if the victim was not negligent

1.4 How a Negligence Rule Works

The problem with strict liability and no liability rules is that they do not induce precaution by the victim and injurer simultaneously. To do this, we need a negligence rule. How does this work?

- The discontinuity in the injurer’s cost at the efficient level means that the injurer takes efficient precaution.
- Anticipating the injurer’s decision to take efficient precaution, the victim perceives that he will bear the residual risk, so he takes efficient precaution as well.

1.5 Errors

- Under strict liability, random errors in setting damages have no effect, and systematic errors in setting damages too high (too low) result in inefficiently high (low) precaution by the injurer

- Under negligence, small errors, random or systematic, in setting damages have no effect, but systematic errors in the standard of care have a one-for-one effect on precaution, and random errors in the standard of care lead to too much precaution.¹
- When the court can assess damages more accurately than the standard of care, strict liability is better (when activity levels and victim precaution are not an issue)
- When the reverse is true, negligence is better (when activity levels and victim precaution are not an issue)
- Under simple negligence, evidentiary uncertainty has the same effect as random errors in the standard of care; comparative negligence partly mitigates this by smoothing the injurer's private cost curve (as compared to simple negligence).

1.6 Accidents between businesses and customers

When victims are not customers:

- Under strict liability, the residual risk of an accident is borne by the taxi driver; under perfect competition, this is passed along to the passenger, so passengers demand the efficient amount of rides.
- Under negligence, the residual risk of an accident is not borne by the taxi driver, so the price does not reflect residual risk, and passengers demand too many rides.

When victims are customers:

- Under strict liability, residual risk is again built into price, so even if customers don't perceive risk they will make efficient choices
- Under negligence, residual risk once again is not built into price, so if customers don't perceive risk they will buy too many dangerous products

1.7 The Hand Rule

The Hand Rule is an American legal doctrine which states basically that failure to take a precaution constitutes negligence if the cost of precaution is less than the cost of the accident times the reduction in probability of the accident (i.e. if it is efficient to take the precaution). However, it is difficult to apply:

- American courts have misapplied the Hand Rule, frequently not taking harm to injurer into account when calculating the cost of the accident.
- Hindsight bias frequently leads people to overestimate the probability of an accident after that accident has occurred.

¹To see how this works, see Tort Law Handout 2.

1.8 Punitive Damages

Punitive damages are generally awarded when the injurer's behavior is "malicious, oppressive, gross, willful and wanton, or fraudulent," and are in addition to compensatory damages. Economically, we may think punitive damages are a good idea when not every victim files a lawsuit, because then the probability that an injurer is sued is not the same as the probability of an accident. This has a similar effect to a systematic error in the amount of damages; if we want to correct it, then, we need to increase the amount of damages.

1.9 Other stuff

- Vicarious liability: employers are liable for torts caused by employees if they are acting within the scope of their employment; gives employers incentive to be more careful who they hire
- Multiple injurers:
 - Joint liability: can sue all injurers together
 - Several liability: can sue each one separately; Several liability with contribution: each only liable for his share
 - Joint and Several liability: can sue either one for full amount; Joint and Several liability with contribution: defendant can sue other injurers for their share

2 Legal Process

2.1 Costs

Two types of costs to the legal process:

- Error costs—inefficiencies due to imperfections in the legal process
- Direct costs—costs of administering the legal system

Thus the efficient legal system is the one that minimizes the sum of these; there is a tradeoff between simpler and more complex rules.

2.2 Class Action Lawsuits

- One person can sue on behalf of a large group ("class") of people
- Useful when individual harms are small but aggregate harms are large

2.3 Costly Litigation

- Litigation is costly; encourages parties to work out a settlement beforehand
- If one party is relatively more optimistic about their chances, negotiations can break down

- Discovery system requires parties to reveal private information they would otherwise choose to withhold. This corrects relative pessimism (making settlement less likely) and makes threat points more clear (making settlement more likely).
- Who pays costs?
 - British rule: loser pays both parties' expenses
 - American rule: each party plays their own expenses
 - Federal Rule 68: if one party offers a settlement more than 10 days before trial, and the other party refuses, the offeree is responsible for legal fees if the judgement is less favorable to them than the settlement offer; gives parties more incentive to make and accept serious offers

2.4 Unitary and Segmented Trials

- Unitary trial considers liability and amount of damages at the same time
- Segmented trial considers liability first, damages second
- In the U.S. the type of trial is up to the judge

3 Criminal Law

3.1 Differences from Civil Law

- Criminal intent (guilty mind, latin *mens rea*)
- Plaintiff is the government—no victim required
- Harm to society as a whole in addition to private citizens
- Higher standard of proof—beyond reasonable doubt instead of preponderance of the evidence
- (Costly) punishment instead of damages
- Intent is to prevent all crime instead of just the inefficient ones

3.2 Why Criminal Law?

Criminal law may work better than tort law to deter crime:

- Perfect compensation may be impossible
- If not all criminals are caught, deterrence requires punishment more severe than the crime
- Criminals may be judgment proof

3.3 Optimal Deterrence

- Marginal social cost of increased enforcement may be positive (by increasing the number of criminals punished) or negative (by reducing crimes committed and number of criminals punished)
- Optimal punishment sets $(\text{expected punishment}) = (\text{harm to victim}) - (\text{marginal cost of deterrence})$
- Two effects of harsher punishments: deterrence (more costly to commit crime) and incapacitation (criminals are already locked up)
- Empirically, increased probability of being caught has a greater deterrant effect than increased severity of punishment

3.4 Punishment

- In the U.S., the most common punishment is imprisonment. In addition to deterrence, this has the effect of incapacitating criminals; this added effect is only effective when the supply of criminals is inelastic. Imprisonment tends to be inefficient: putting someone in prison is costly and makes them worse off.
- In Europe, many crimes are punished by fines. Fines are efficient, but create the potential for abuse, since the money must go somewhere.
- In the U.S. the death penalty is extremely expensive due to additional legal safeguards; it's currently more expensive in the United States to execute someone than to imprison them for life.
- Additional punishment for crime: Stigma
 - People don't want to hire convicted criminals; having a conviction on your record is an extra punishment
 - In the absence of wrongful conviction, stigma has negative social cost, since it gives people information about criminals' proclivity to commit crime.
 - However, stigma increases the cost of wrongful conviction, since in this case it gives people bad information. This suggests that criminal cases should have a higher burden of proof than civil ones.