The Economics of the Litigation Process II

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Class Action Suits

- In 1997, the tariff for local calls in public payphones in Buenos Aires was 22 cents.

- At the same time, phones didn't accept 1 cent coins, so the minimum that a user could pay was 25 cents.

- Illegitimate transfer from users to the company $\sim$ 10M usd.

  - Problem: dispersed cost.

    - Multiple victims.
    - Large aggregate damage.
    - Small individual damages.

Class Action Suits

- Consider:
    - n victims, D damage each.
    - cost of filing c.

- One solution: **Class Action Suits**.
    - Bundle all claims in a single suit.
        - It overcomes the problem of invidual incentives to file suit.
        - Is saves on judicial resources.
    - Issues:
        - Underinclusion: not all victims are reached.
        - Overinclusion: uninjured parties that claim to be victims.

Class Action Suits

- When are Class Action Suits appropriate:
    - Costs are dispersed: stakes are large in the aggregate and small for any individual.

- Plaintiff represents the victims (*class*).

- If plaintiff succeeds (accepts settlement or wins the trial), defendant must pay damages.
    - How should damages be distributed to the victims and plaintiff?
    - Trade-off: incentives and fairness.

Class Action Suits

- Risk:

    - With only one suit, results are positive correlated.
    - Total risk goes up.
    - This might increase the willingness of the defendant to settle.

- Before we analyzed the settlement for risk-neutral defendant.

- A risk-averse individual might be willing to settle for x each individual claim, but willing to pay $X > nx$ not to go to trial in the class action case.

Frivolous Suits

- Suits that have negligible chance of succeeding at trial.

    - Why sue? Settlement value.

- Back to the optimism model, we said that settlement was feasible iff:

    - $p\psi - C_p \leq S \leq q\psi + C_d$

- Notice that settlement is feasible if $p = q = 0$!

Frivolous Suits

- Even though settlement is feasible, trial is not a credible threat.

    - If defendant offers $S = 0$, a rational plaintiff will take the settlement.

    - Moreover, the defendant could offer $S = -C_p$.

    - The success of a frivolous suit depends on the **credibility** of the plaintiff of going to trial.

- How can we go around the credibility problem?

    - Asymmetric information.

    - Nash Bargaining.

References