

Economic Analysis of Law
Villanova -- Spring 2019
The Armageddon
Klick

Please submit your answer to the following question to jklick@law.upenn.edu with the subject line "Klick LE Exam" by 6 pm on Wednesday February 27, 2019. You may consult any outside materials in formulating your answer, but please do not confer with any other individual (including, but not limited to, your classmates) in the process of completing the exam. Also, even if you submit your exam before the deadline noted above, please do not discuss the exam with anyone prior to March 1, 2019. If you want to include graphs or other illustrations in your answer, feel free to scan/photograph hand-drawn graphs and submit them in separate files if it is easier for you than embedding them in the main test file (of course, feel free to insert them in the main file if you prefer to do that). Good luck.

Question:

Provide an economic rationale for the existence of class action lawsuits. Although fees for the plaintiff-side lawyer are contingency fees, generally on the order of 10-40 percent of whatever damage award or settlement amount the plaintiff lawyer secures for the class (subject to judicial oversight) plus reasonable costs incurred, make an argument (based on your rationale for class actions) that the plaintiffs' lawyer should be given the entire award or settlement amount. What are the counter-arguments?

There are situations where individual harms are small but aggregate harms are large. For example, if a credit card company charges unjustified fees of \$10 per person, no individual will find it rational to litigate (and therefore undertake costs such as filing fees, lawyers fees, etc) against the fees even though the fees may amount to millions of dollars for society. Given this, the credit card companies may have an incentive to charge small fees and will not be deterred from doing so by the threat of litigation. Class actions, by giving the lawyer an incentive to bring and litigate the case, have the potential to generate deterrence in these situations.

However, if the lawyer only gets 10%-40% of the settlement/judgment, s/he will not be incentivized to put in optimal effort (the lawyer bears 100% of the cost but only gets 10-40% of the benefit, therefore s/he will not exert effort up to the point where $MB=MC$). This, presumably, will lead to insufficient deterrence. This could be fixed by simply paying the lawyer 100% of the judgment/settlement.

Counterarguments could include a lack of compensation for the victims. They could also include arguments that defendants are already over-deterred by litigation (because of plaintiff friendly juries, bad law, etc) or that market forces already deter some behavior (e.g., in the credit card example above, people would probably stay away from companies that engaged in this behavior).