CHAPTER 7

JUDGE-MADE LAW AND THE COMMON LAW PROCESS

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One of the most illustrious normative claims in the law and economics literature, originating with Posner and supported by models of evolutionary legal change, posits that a system of judge-made law offers efficiency advantages over statute-based systems. In recent years, however, scholarship has identified aspects of common law systems that undermine the optimism about judge-made efficiency. This chapter reviews the original economic literature on the efficiency of the common law and describes supply and demand-side obstacles to convergence to efficient legal precedents.

7.1 The Efficiency of the Common Law Hypothesis

One of the most well-known normative claims in law and economics literature is that a system of judge-made law is superior to legislation in producing efficient rules.[1] In his pioneering work Posner analyzed various legal common law doctrines and concluded, on the basis of an intuitive measuring of benefits and costs, that the common law is efficient (Ehrlich and Posner, 1974; 1992; first edition, 1973). These writings helped spark the

[1] The original claim (Hayek, 1960) predates the law and economics movement. For an argument to the contrary, see Tullock (1980, 1997). On the value of a mixture of case law and statute-based legal rules, see Ponzetto and Fernandez (2008). Empirical work has provided some support for the Hayekian argument that common law systems perform better economically by giving less power to the state than civil law systems. See, e.g., Mahoney (2001); Glaeser and Shleifer (2002); Beck, Demirgüç-Kunt, and Levine (2003). But see Klerman et al. (2011).

law and economics movement, inspiring a generation of scholars to apply the economic toolkit to examine doctrines across various areas of law.[2]

Several foundational writings have further substantiated the efficiency thesis. First, a strand of literature turned to supply-side aspects of case law, focusing on utility maximizing behavior by judges. Posner (1973) claims that judges derive utility from writing efficient decisions since they are insulated from other motives such as personal interest and interest group pressures[3] and do not see enough cases to engage in widespread social distribution.

Second, a number of pioneering works identified processes within systems of judge-made law that induce efficient outcomes over time. Rubin (1977) posits that inefficient doctrines are under greater evolutionary pressure than efficient precedents. While efficient precedents generate settlements, inefficient decisions create losses to one party that are greater than the gains to the opposing party that cannot be bargained away in the settlement process. For parties that have an ongoing interest in the dispute, the prospect of these deadweight losses in future cases, creates an incentive to challenge the inefficient precedent. As a result, inefficient decisions are subject to greater selection pressure, and subject to litigation more often than efficient decisions. Over time, this selection effect filters out inefficient precedents.

Priest (1977) extended the model by Rubin, showing that, by imposing greater costs on the parties than efficient rules, inefficient precedents increase the stakes in a dispute. By increasing the stakes, inefficient precedents are more prone to litigation and increased selection pressure—even if parties don't have an ongoing stake in the underlying issue. As inefficient rules continue to be challenged in court, the review process increases the opportunities to discarded inefficient precedent in favor of more efficient variants that are less likely to be reviewed. Overall, the legal system perpetuates selection of increasingly efficient legal rules. Goodman (1979) argues that efficient precedents are more valuable to potential beneficiaries than inefficient decisions and hence more likely to be subject to investments in litigation.[4]

These foundational writings prompted a number of refinements to the efficiency thesis. Landes and Posner (1979) point out that the selection effect pressure is weakened by the basic fact that precedents are not binary and existing precedents might be weakened or strengthened (and sometimes entrenched) rather than overturned.[5] Other, more complicated models of litigation present a possibility of multiple equilibria in

[2] For an overview of the field of law and economics, see Bouckaert and De Geest (2000); Newman (1998); Posner and Parisi (1997).

[3] This presumed judicial taste for efficiency is questioned by subsequent work on judicial attitudes and voting preferences, see section 7.2.2.

[4] See also Katz (1988) with an extension considering the role of litigation expenditures. Stake (1991) distinguishes different areas of law, finding that property law is more likely more susceptible to efficient evolutionary forces than tort law. For a similar argument pointing to contract law's superiority over tort law, see Barzel (2000). Terrebonne (1981) presents a general model.

[5] Heiner (1986) explains *stare decisis* and other features of civil procedure as mechanisms that minimize the costs of error in human decision-making.

which efficient and inefficient decisions may co-exist (Cooter and Kornhauser, 1980; Kornhauser, 1989; Von Wangenheim, 1993). Although a common law system might have a propensity towards efficiency, this outcome is by no means guaranteed. Borrowing from chaos theory, Roe (1996) describes how initial conditions, path dependence and evolutionary accidents can alter legal evolution.

The common law efficiency thesis raised interest in the field of law and economics and helped set a research agenda for years to come (Aranson, 1986). Several decades later however, a rich body of literature challenges the efficiency determinism of the earlier law and economics contributions on judge-made law. We first turn to supply-side complications in section 7.2. Section 7.3 provides an overview of demand-side impediments to efficient judge-made law.

7.2 Supply-Side Complications

While much of the original literature on the efficiency of the common law focused on the role of litigants in the convergence towards efficiency, in recent years scholars have focused attention on the supply-side of legal change. A rich body of literature on judicial decision-making and judicial attitudes casts doubt on the ability as well as the motivations of courts to bring about efficient precedent.

7.2.1 Judicial Attitudes and Preferences

In a classic paper, Cooter et al. (1979) presented a model that showed that a movement towards precedent efficiency necessitates that judges deliberately desired efficient outcomes.

A vast body of literature has examined judicial preferences during the past three decades. Early contributions by Miceli and Cosgel (1994) and Rasmusen (1994) state that judges are motivated by a combination of individual preferences, on the one hand, and a concern with reversal by higher courts or future judges, on the other hand.[6]

A growing body of empirical research indicates that political and ideological preferences influence judicial voting patterns (Brudney, Schiavoni, and Merritt, 1999; Sunstein, Schkade, and Ellman, 2004; for an overview, see Epstein et al., 2013). A strong relationship is observed between the ideology of justices and voting behavior on the Supreme Court (Segal and Cover, 1989; Segal and Spaeth, 2002). Empirical evidence also

[6] Higgins and Rubin (1980) posit that since promotion is a likely motivation of judges, judges seek to avoid reversal and the value of promotion reduces with age. In their sample, the authors found only a weak relation between reversal and promotion and no relation obtained between age or any other factor and reversal, however. Other early work includes Landes and Posner (1980) on differences between federal and state judges given salary differences and life tenure and Ashenfelter, Eisenberg, and Schwab (1995) on influence on judicial outcomes of the political party appointments.

confirms a relationship between political attitudes and voting behavior on the federal appellate level (George, 1998; Songer and Davis, 1990; Songer and Haire, 1992; Sunstein, Schkade, and Ellman, 2004). Goldman (1966, 1975) uses political party affiliation and other variables to explain judicial decisions on circuit courts. Panel compositions and political affiliations also help explain voting outcomes, as has been demonstrated by Revesz (1997) and Sunstein, Schkade, and Ellman (2004).[7] Carp and Rowland (1983) and Rowland and Carp (1996) provide evidence of the impact of political preferences of trial court judges on judicial outcomes.[8] The available evidence suggest that ideological bias is present especially on salient issues, such as civil rights and liberties (Sunstein, Schkade, and Ellman, 2004) and less pronounced in less polarized areas of law such as tax and securities (Schneider, 2001, 2005; Grundfest and Pritchard, 2002).[9]

Finally, a growing literature in law as well as political science considers forces that may constrain the ability of judges to vote in accordance with their preferences altogether—efficiency oriented or not. These external constraints include the preferences and likely actions of politicians (Eskridge, 1991; Bergara, Richman, and Spiller, 2003; Kang and Shepherd, 2015) and of voters in judicial elections (Brace and Boyea, 2008; Huber and Gordon, 2004; Shepherd and Kang, 2014).[10]

7.2.2 Internal Constraints

Even if judges were determined to maximize efficiency in case law, several obstacles remain.

First, courts see only a small sample of potential disputes (Hadfield, 1992). Moreover, court proceedings do not provide judges with the type of information necessary to engage in the type of planning that would be necessary to set about efficiency within legal systems (Aranson, 1992; Rizzo, 1980a).[11]

Second, judges are prone to the systematic errors in judgments that have been highlighted in the literature on psychological and cognitive biases (e.g., Gilovich, Griffin, and Kahneman, 2002; Kahneman, Slovic, and Tversky, 1982). Experimental studies involving federal magistrate judges, find that judges appeared susceptible to many of

[7] See also Hettinger, Lindquist, and Martinek (2006) on ideological positions as an explanation for reversals of lower court rulings and the writing of dissenting opinions.

[8] Studies on state courts find lower and sometimes no relationship between judges' attitudes and outcomes (cf. Pinello, 1999; Gibson, 1978; Nardulli, Flemming, and Eisenstein, 1984). Because measures of judicial attitudes are more difficult for state court judges, partisanship is often used as a proxy for ideology in these studies, however (Brace, Langer, and Hall, 2000).

[9] Generally, political bias might have deferring effects across areas of law.

[10] Measuring television advertising for state supreme court elections, Shepherd and Kang (2014) observe how judicial election pressures impact voting against appeals by criminal defendants. Kang and Shepherd (2015) find that contributions from political parties are associated with partisan judicial voting.

[11] Similarly based on insights from Austrian economics Rizzo (1980b) notes that information shortcomings impede judicially efficient outcomes. Rubin (1980a) notes that the Austrian information cost argument applies to efficiency determination in all economics, not merely law and economics.

the biases observed in lay decision-makers, including anchoring, framing, hindsight bias, the representativeness heuristics, egocentric biases (Landsman and Rakos, 1994; Guthrie, Rachlinksi, and Wistrich, 2001; Englich et al., 2006), risk mistreatments (Viscusi, 1999).[12] For instance, demands made at pre-hearing settlement conferences anchored judges' assessments of the appropriate amount of damages to award in the case (Wistrich, Guthrie, and Rachlinski, 2005). Although the federal and state appellate review system provides an opportunity for correction (Shavell, 1995), these findings increase the risk of judicial error in ways that may impede efficient outcomes.

7.2.3 Structural Variables

O'Hara (1993) provides a game theoretical perspective to describe how appellate judges are motivated to follow precedent in order to prevent punishment in the form of ignorance of their decisions by other judges on the bench. Such repeat game interaction provides horizontal adherence to prior decisions even in the absence of formal *stare decisis*.

Zywicki (2003) describes several institutional changes that have rendered the common law more vulnerable to rent-seeking pressures and inefficient outcomes in recent decades. By contrast, in the old common law system judges and courts competed to supply efficient rules to get the business of disputants.[13]

Whitman (2000) provides a model of self-interested decision-making where judges decide whether to follow the precedent or to announce an alternative rule, "preference satisfaction," and reaps a reputational gain if the next judge upholds her decision or a reputational loss otherwise. Whitman finds that if division of opinion among judges is low relative to the strength of judges' activist tendencies, a common law system will converge on a single rule. The reason is that even activist judges who disagree with a precedent will follow the precedent anyway, for fear of rejection by subsequent judges. If division of opinion is high however, oscillation between the two rules will take place and legal indeterminacy will undermine the efficiency of the law.

Gennaioli and Schleifer (2007a) consider a model of legal change of partial judicial bias in a system of precedent. Even if judges primarily seek efficiency they may possess a bias for one or the other side in a legal dispute that can cause the law to diverge from the efficient path. While policy-biased judges distort the law away from efficiency, a diversity of judicial views also improves the quality of the law because applying new facts to existing precedent increases the precision of legal rules.[14]

[12] Although some of the results are less pronounced than the findings with regard to laymen and jurors (Chapman and Bornstein, 1996; Hastie, Schkade, and Payne, 1999; Hinsz and Indahl, 1995; Malouff and Schutte, 1989; Raitz, et al., 1990; Hans and Vidmar, 1986; Robbennolt and Studebaker, 1999), the basic finding is that even trained and experienced judges are prone to systematic errors due to cognitive limitation, biases, and heuristics.

[13] Klerman (2007) describes how competition among courts infused pro-plaintiff bias in the common law.

[14] In a related paper, Gennaioli and Schleifer posit that the possibility of overruling leads to unstable legal rules that rarely converge to efficiency (2007b).

Miceli (2009) provides an analysis that considers both the impact of judicial bias as well as the impact of selective litigation. The two main conclusions are that (1) judicial bias can impede the efficient evolution of the law by case selection if the fraction of judges biased against the efficient law is larger than the conditional probability that a case being litigated involves an inefficient law, and (2) precedent affects the rate of legal evolution but not the direction of the law; specifically, weaker precedent speeds the rate while stronger precedent slows it.

7.3 Demand-Side Complications

7.3.1 Interest Groups Effects

Hirshleifer (1982) highlighted that evolutionary forces are shaped not just by the ongoing interests and stakes of respective parties in litigation, but also by the capabilities to organize efficiently and effectively. Judicial outcomes might favor parties that are best equipped to mobilize resources for litigation. Repeat-play, scale effects, and reduced learning costs, provide an advantage to parties with larger stakes (Galanter, 1974) in common law systems as well as in statute- or code-based legal systems. In this regard, the common law's superior isolation from interest group pressure was only temporary since the common law developed when collective action by interest groups was still expensive (Rubin, 1982).[15]

7.3.2 Plaintiff Selection Effects

Rubin and Bailey (1994) explore the role of tort lawyers as a successful interest group with a stake in the expansion of tort law. Plaintiff lawyers have an ongoing stake in the rise of tort awards and remedies over time, as well as increased uncertainty and litigation costs, in the absence of any potentially offsetting pressure from other stakeholders. Defendants are interested only in the case at hand and face several difficulties (including antitrust) to organize effectively, even when situated in the same industry. Defense attorneys have an agency conflict with their clients since more expansive and costly tort law increase the value of defense lawyers. Consumers are dispersed and have a harder time organizing. Finally, insurance companies have an interest in minimizing liability in the instant but in the long run also gain business when the liability system is more costly (see also in the context of product liability, Viscusi, 1991). Collective action among

[15] Extensions include Crew and Twight (1990) (finding common law less subject to rent-seeking than statute-law-based systems) and Rowley and Brough (1987) (finding that contract law and property law are less subject to rent-seeking in a common law system but not tort law). For a formal model on rent-seeking on the law, see Bailey and Rubin (1994).

trial lawyers, including through the Association of Trial Lawyers in America (ATLA), provides information pooling that is conducive to winning favorable outcomes and improving precedent to other lawyers active in the same area of law (Rubin, 2005).

Fon and Parisi (2003) examine selective litigation decisions by plaintiffs facing judges with varying ideologies. Their model acknowledges that judges recognize the binding force of prior decisions, but they have different policy perspectives and propensities to expand the scope of legal remedies and cause of action, especially in marginal or borderline cases where a gap in the law or novel ambiguity must be addressed. Plaintiffs make rational estimates of likely case outcome, given the sitting judges and or composition of the court panel. Given the opportunity of plaintiffs to engage in forum-shopping and to file marginal cases in pro-plaintiff jurisdictions, liberal judges more frequently get the opportunity to create pro-plaintiff precedents than conservatives have opportunities to set pro-defendant precedents. In this process, marginal cases that are unlikely to find support in current case law are unlikely to be brought before a conservative court. Once adjudicated, this pro-plaintiff biased flow of precedents gradually becomes an interpretative benchmark for all future judges. So, even if parties have symmetric interests in future similar cases, and litigation is exclusively driven by the attempt to maximize returns from the case, case selection might create a strong bias toward pro-plaintiff evolution of the path of the law.

In an extension, Luppi and Parisi (2010) observe that this plaintiff selection effect is muted somewhat in legal systems that anonimize judicial decisions. Conversely, plaintiffs are better positioned to make out the ideologies of judges when judges individually sign majority decisions, concurrences, and dissents. For this follows that, all else held equal, the greater anonymity in continental legal systems make these systems less vulnerable to plaintiff selection effects than common law systems.

Depoorter (2011) provides a twist on plaintiff selection effects, predicting that under certain circumstances, plaintiffs with an ongoing interest in the issue will strategically pursue losing litigation in order to obtain the potentially countervailing benefits of public and political mobilization. The precedent costs of a loss in trial might be offset by the expected benefits of mobilizing public and political support. Especially when carefully selecting sympathetic plaintiffs, media attention to the losing party, the underlying cause, and the adverse judicial precedent may create pressure on legislative bodies to change the legal status quo.

7.3.3 Information Selection Effects

Hylton (2006) provides a general model that shows how judge-made law can trend over time in favor of litigants with meritorious cases that possess superior information (e.g., Bebchuk, 1984), as relating to the prediction of the case outcome. Since the Priest–Klein (1984) model predicts that (1) a dispute is more likely to go to judgment if the standard's application to the particular practice is highly uncertain, (2) the rational components of the litigant's predictions are identical, plaintiffs and defendants

are equally likely to win (litigation likelihood ratio = 1) and the path of the law is not biased (Priest, 1980). Hylton points out, however, that when there is asymmetric information, the relative frequency of litigation favors more informed parties with meritorious case. While informed and non-meritorious disputes (for instance, guilty physicians facing medical malpractice claims) tend to settle, informed and meritorious litigants litigate to judgment. In the presence of asymmetric information then, the path of the law is disproportionally shaped by the information provided by innocent litigants in court. The disproportionate presence of innocent defendants influences the path of the law by the "litigation likelihood ratio" of innocent to guilty litigants but Hylton posits also that case law becomes "informationally biased." A legal standard will move from ambiguity to higher degrees of precision on the basis of information provided by innocent defendants; for instance by identifying specific types of non-negligent conduct. Over time, this informational bias could lead to "rule evolution" as the information embodied in legal rules alters the nature of the rule itself. Although Hylton's model does not suggest an unambiguous trend toward efficient judge-made law, the information-biasing process aligns well with the common-law efficiency hypothesis since informed and meritorious parties are more likely to produce efficient outcomes.

7.3.4 Settlement Selection Effects

Depoorter (2010) highlights the influence of civil settlements on legal change. Given the impact of non-legal factors (ability to bear litigation costs, diverging risk attitudes, asymmetric information, the principal–agent issues, cognitive limitations, headline sensitivity) on negotiated outcomes,[16] settlement trends diverge from available legal remedies. Settlement trends are biased since information on novel settlements featuring high awards and novel remedies circulate more widely in specialized reporters, professional interest organizations, mass media coverage and the oral culture in legal communities. Such novel civil settlements may have a one-directional ratchet effect on the path of the law as individual settlement concessions make it more difficult for similarly situated defendants to deflect future claims. Ambitious trial lawyers use innovative settlements as benchmarks, making plaintiffs in future cases more reluctant to accept settlements below what others have agreed to in prior, analogous cases. Also, the non-coercive nature of settlements may frame the normative outlook on novel legal claims and are less likely to be perceived as outrageous by judges and juries if such claims have been gratified by a prior settlement concession. Overall, prior settlement concessions may thus create sustained pressure towards higher awards and novel remedies, resulting in a gradual expansion of the legal system.

[16] See, e.g., Mnookin and Kornhauser (1979).

7.3.5 Procedural Factors

Fon, Parisi, and Depoorter (2005) examine the effect of judicial path dependence on the consolidation and contraction of liability rules and legal remedies when judicial decisions do not become a source of law until they mature into a prevailing line of precedents. In such a system the increase in the scope of remedies does not necessitate a selection effect. Instead, asymmetric stakes and judicial path dependence are sufficient to lead to gradual consolidation or contraction of legal remedies. Due to asymmetric stakes in litigation cases can be rationally pursued also when the probability of success is fairly small. In this process, a large number of negative precedents that deny a new cause of action or restrict the scope of an existing remedy may come about. For instance, in this dynamic process of case selection, an increase in the win/loss ratio and a decrease in litigation costs, increase the scope for gradual contraction of remedies, since they render smaller probability cases worthy of pursuit. Conversely, in other instances an initial judicial innovation may be followed by a small fraction of early favorable decisions could lead to wider acceptance and eventually consolidate into a binding doctrine.

Luppi and Parisi (2012) examine the differential effect of the American and the British or Continental allocation of litigation costs on the path of judge-made law. Under the American rule, where each party is responsible for his or her own legal expenses, some cases with small probability of success are filed that would not be filed under the British rule where the loser pays part of the costs of the winner (Shavell, 1982). Over time the American rule's low probability cases may accumulate negative precedents, decreasing the likelihood of success of similar cases in the future.

7.4 Conclusion

One of the most illustrious normative claims in the law and economics literature, originating with Posner and supported by models of evolutionary legal change, posits that a system of judge-made law offers efficiency advantages over statute-based systems. This strand of scholarship helped spark the law and economics movement, inspiring a generation of scholars to apply the economic toolkit to examine doctrines across various areas of law.

In recent years, scholarship has greatly expanded and refined economic models of legal evolution. The overview of the literature in this chapter illustrates that these advances undermine some of the initial optimism about judge-made efficiency.

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