EDITORIAL

- *Dr. Ranita Nagar*

It gives me immense pleasure to present the second issue of the GNLU Journal of Law & Economics, published by the GNLU Centre for Law & Economics. The conception and the development of this journal has been a thorough academic exercise, directed towards increasing student inclination towards the profound subject of law and economics. The Journal also wished to remain accessible, which is why it is freely available online, staying committed to its key goal of spreading knowledge about law and economics.

The discipline of law and economics is increasingly attracting legal attention. It seeks to offer a new way of understanding law and legal systems, and measuring their efficiency. Ensuring efficiency and a positive social surplus are key to create better legal systems. The recent validation of experimental economics in law and policy recognized by The Nobel Prize in Economics opens exciting possibilities of designing scientific interventions to design the law with accuracy. Some of the best minds in the world are developing their expertise in this subject, owing to its massive scope and capability in improving the way we view laws and develop them. In fact, the Supreme Court of India has also been progressively increasing its dependence on principles of law and economics in its decisions.

To call the study of economics intertwined with law an important backbone to legal studies would be an understatement. This study can help lawyers make better arguments, and understand the economic ramifications of laws. To encourage this, the GNLU Centre for Law & Economics organised an Essay Competition on Law & Economics. It was incredibly heartening to see a number of students show their interest in the field, and come up with a large number of unique entries. The best entry of this year's competition has also been featured in this issue of the Journal. I wish the heartiest congratulations to the winners, as well as to all the participants for their interest in the subject.

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To give a little bit of background into the growth of this journal, Gujarat National Law University has always been motivated to create an environment for research-based training and learning. All subjects are taught keeping in mind an inter-disciplinary approach to learning, and students are encouraged to develop a holistic outlook to equip them to serve the legal community better. The GNLU Centre for Law & Economics plays a crucial part in furthering this aim. Since its inception, the Centre has been dedicated through its members in achieving value addition and capacity building in the expanding horizon of law & economics. The Centre has exemplified this by way of several ventures in both research projects as well as organising sessions with experts in the field, in person and by way of Skype lectures. The Centre also eases the transition into an economic way of thinking for first year students who are just joining college by way of creating a support programme for students transitioning from different streams who have no experience in the study of economics. The focus on economic thinking is seen in the course outlines at Gujarat National Law University, wherein major economics subjects are taught over three semesters, the Ist, IInd and the VIth semesters. The Centre also promotes the ideas and ventures of its students, leading to several student run groups, working on Section 138 of the Negotiable Instruments Act, and the Consumer Protection Act 2019. These research ideas are fostered within the Centre, and mentored by Centre Professors who guide these research ideas and help students deliver high-quality work, with conclusions supported by empirical evidence. The programmes organised by the Centre are focused on relevant and important issues, and have attracted a large amount of participation, such as our most recent programme on the Insolvency and Bankruptcy Code.

In the ethos of adding to the existing academia of law & economics, the Centre created the GNLU Journal of Law & Economics. The inaugural issue received support from a greatly renowned advisory board including Hon'ble Justice Sikri, and Hon'ble Justice Dr. D Y Chandrachud and eminent professors in the field such as Prof. Tom Ginsberg and Dr. Hans Bernard Schafer. The issue featured articles from renowned authors like Dr. Nuno Garoupa, Dr. Thomas Ulen and Dr. Regis Lanneau.

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Contributions

This second issue contains six articles, from authors all around the world. These comprise of economic analyses of several key dimensions of law such as constitutionalism, jurisprudence and corporate law. To solve some of the world's problems, is the outlook that all these articles echo, and they apply law & economics to these complex issues to present unique solutions.

In her article titled Economic Rights: Issues & Suggestions with Reference To Constitutionalization, Adjudication & Policy Making, Palak Jain gives an outlook into the acknowledgement of economic rights in different jurisdictions. She explains that while these rights are adopted and institutionalized, their application to policy making remains poor. Enforcing these rights is a futile and tedious exercise, and the author goes over their judicial interpretation to explain the same. She examines that while such rights are in vogue, their simple recognition does not afford any adequate solution. She explains the barriers which arise in the implementation of economic policies and explains how policy makers often reduce public utility to ensure personal gain. She also gives a three-pronged approach to how better fulfillment of economic rights can be achieved.

Mark D. White presents a paper of jurisprudential importance as he focuses on The Neglect of Rights in Law & Economics. He refers to the utilitarian background of the growth of law & economics and how the same has resulted in a disregard for individual rights within the discipline. He explains how the understanding of the term efficiency in economics focuses on the bigger benefits, and disregards the minority who suffers to create these surpluses. He explains how an economic approach to law focuses on creating efficient levels of harm, rather than eliminating harm whatsoever, which ideally should be the aim of law. He puts an economic analysis of law on the backburner, stating that it must always yield to the protection of individual rights.

Lucas Bento examines the popular corporate structure of limited liability in his paper entitled Corporate Law & Economics of Limited Liability: A Perspective Overview and Some Open Questions? He gives a background to the reasons for the development of

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limited liability as a corporate structure. He also refers to how it is necessary to create a well-defined distinction between management and risk sharing in business enterprises, and also defined circumstances wherein courts have pierced the corporate veil to protect the interests of shareholders.

Frank Fagan explores an interesting drift between standardization and competition in his paper entitled Standardized Data Collection: Legal Requirements, Guidelines or Competition. He explains that while standardized data collection helps in ensuring economies of scale, it can have an adverse impact on competition and innovation. Once certain standards are set, it may be possible that they become outdated, and therefore, it may be difficult to ensure constant development. He describes the role of law in ensuring both a coordinated process for data collection in terms of both procedure and substance.

With the rapid slowdown in the automobile sector in India, Soumya Hariharan, Nandita Sahai, Sakshi Agarwal, and Akrathi Reddy's paper titled Fuelling Compliance with Competition Law: Competition Law & the Automobile Sector describes the most recent trends in the competition market dealing with combinations and abuse of dominance in the automobile sector. By describing the most recent developments in the sector, the authors suggest how enterprises in the automobile sector can develop competition compliant practices in order to protect themselves from dawn raids carried out by the Competition Commission of India.

Shubhangi Maheshwari discusses the possible ramifications of a contingency fee structure for lawyers in her paper titled Allowing Lawyers to Charge Contingency Fees: Impact on the Legal Services Market. The paper argues in favour of such fees and illustrates how the same could be beneficial to all stakeholders in the legal market. By applying a traditional market analysis to the legal profession, she explains how a situation of market failure arises in the legal market owing to improper allocation of risk between the lawyer and the client. She also explains how a system of contingency fees can substitute the current legal aid system.

It is truly heartening to such a diverse range of topics being explored from the point of view of law & economics. This truly goes a long way to show the pervasive nature of the

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discipline, and its impact on diverse spheres of law and life. We hope that the readers of this edition shall also enjoy having an economic outlook on so many different topics.

Acknowledgement

Developing this journal from an idea to an actuality, and continuing it to its second edition has been an enthralling experience. I am grateful for the supported accorded to this venture by our institution Gujarat National Law University, and its Director, Prof. Dr. S Shanthakumar. I am also grateful to Prof. Dr. B. Patel, former Director, Gujarat National Law University, for his continued encouragement and support since the inaugural issue of this Journal.

My colleagues within the Centre have also worked tirelessly to constantly inspire this journal, on this note, I wish to thank Dr. Hitesh Thakkar, Assistant Professor of Economics and Dr. A. Marisport, Assistant Professor of Law. Our Board of Advisors have also shown tremendous support to this venture, and my sincere gratitude goes to them.

I also wish to thank all the Teaching and Research Assistants as well as the administrative staff who joined me on this journey. This was a journey for the benefit of my students, who have put in efforts to ensure that the highest quality standards of this journal are maintained. Therefore, a sincere thanks is also due to the student editorial team who has worked on this journal tirelessly

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FUELLING COMPLIANCE WITH COMPETITION LAW: COMPETITION COMMISSION OF INDIA AND THE AUTOMOBILE SECTOR

- Soumya Hariharan, Nandita Sahai**, Sakshi Agarwal***, Akrathi Shetty*****

I. INTRODUCTION

The automobile sector has undergone significant consolidation, witnessed the entry of new players and joint ventures amongst automobile companies and proliferation of innovative distribution models for sale of automobiles in India. Antitrust regulators across the globe have undertaken detailed scrutiny of the automobile sector, owing to its significant economic value, distribution models, aftermarkets[1] and consumer interest. From an enforcement standpoint, the CCI has assessed the automobile sector for cartels, anti-competitive vertical arrangements, i.e., exclusive dealing, resale price maintenance (**RPM**), tie-in arrangements and refusal to deal, and abuse of dominance. The CCI has imposed significant penalties on automobile companies found guilty of indulging in anti-competitive conduct.

The CCI has assessed approximately 40 combination cases until 2019, under its merger control regime, covering a number of players such as automobile component manufacturers, Original Equipment Manufacturers (**OEMs**), Original Equipment Suppliers (**OES**), manufacturers of tyres, etc. While assessing the automobile sector from a merger control perspective, the key parameters considered by the CCI include, market shares of the parties to the combination, number of players, existing and potential vertical relationships, vertical foreclosure, nature of operations, and overlaps between the parties, etc.

* Partner, Competition Law, Trilegal.
** Senior Associate, Competition Law, Trilegal.
*** Senior Associate, Competition Law, Trilegal.
****Associate, Competition Law, Trilegal.

[1] The market for supply of spare parts, including the diagnostic tools, technical manuals, catalogues, etc., and provision of after sale services, including servicing of vehicles, repair and maintenance services.

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II. RISKS

The key risks that companies in the automobile sector are likely to face may result from manufacturers restricting their dealers from selling their spare parts, tools, etc., over the counter, or collaborations between OEMs and OES leading to exchange of information that could potentially result in imposition of restrictive clauses. Tie-in arrangements requiring customers to purchase products other than the vehicle itself, such as, sound systems, Compressed Natural Gas (**CNG**) kits, etc., may also be considered anti-competitive. Further, procurement of automobile components by OEMs could lead to collusion amongst the common OES. OES providing parts to multiple OEMs may act as conduits of information exchange amongst the OEMS. Other competition law contraventions that are likely to arise in the automobile sector include price-fixing and bid rigging for various products in the automobile sector. The Director General (**DG**)[2] has been investigating various domestic and global automobile companies for their participation in alleged anti-competitive practices having an appreciable adverse effect on competition (**AAEC**) in India.[3] To date, the CCI has scrutinised approximately 100 cases in this sector, most of them having arisen on account of leniency applications.[4]

Several automobile component manufacturers, specifically OEMs, have availed the benefit of India's lesser penalty regime by filing leniency applications with the CCI. Section 46 of the Act and the Competition Commission of India (Lesser Penalty) Regulations, 2009 (**Leniency Regulations**), govern the leniency regime in India. Companies and individuals who provide vital disclosures by submitting evidence of a cartel and subsequent companies and individuals who provide 'added value' to the evidence that is already in possession of the CCI, may benefit from the leniency regime. The reduction in penalties that may be awarded to such companies and individuals depends on the quality of evidence submitted and timing of the disclosure made to the CCI.

[2] The investigative arm of the CCI.

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Recently, the CCI passed its first order based on a lesser penalty application in the automobile sector, where it imposed a penalty of approximately INR 17 crores[5] on Japan's JTEKT Corporation (**JTEKT**) and its Indian subsidiary JTEKT Sona Automotive India Limited (**JSAI**) for colluding with NSK Limited, Japan (**NSK**) and its Indian subsidiary Rane NSK Steering Systems Ltd. (**RNSS**).[6] The cartel pertained to the supply of Electric Power Steering Systems (**EPS Systems**) to three automotive manufacturers, by means of directly or indirectly determining price, allocating markets, co-ordinating bid response and manipulating the bidding process. NSK/ RNSS received complete immunity amounting to a 100% reduction in penalty, as the first leniency applicant. JTEKT/JSAI as the second leniency applicant availed a 50% reduction in penalty on account of it providing significant added value to the evidence already in possession of the CCI to establish the existence of the cartel in India. Notably, the conduct of former employees was also investigated by the CCI for their role in the cartel at the time when the contravention was committed. This case signifies the CCI's willingness to conduct an in-depth scrutiny, including investigating former employees, when assessing contraventions against the Act. Companies and individuals in the automobile sector may benefit from the leniency regime by availing reduction in penalty for anti-competitive conduct and pro-actively assisting the CCI in cartel enforcement.

The National Company Law Appellate Tribunal (**NCLAT**) which is the appellate tribunal has also assessed certain cases in the automobile sector, dealing with vertical restraints imposed through RPM by limiting discounts offered by dealers and abuse of dominance by OEMs[7] in the secondary market for repairs and maintenance services, which are currently pending on appeal to the Hon'ble Supreme Court of India (**SC**).

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[3] Veena Mani, *CCI issues 100 notices to auto parts firms to investigate global cartels*, BUSINESS STANDARD (Mar. 5, 2018, 9:40 PM IST), https://www.business-standard.com/article/companies/cci-issues-100-notices-to-auto-parts-firms-to-investigate-global-cartels-118030501169_1.html.

[4] Annual Report, COMPETITION COMMISSION OF INDIA, 14 (2017-2018).

[5] USD 2.35 million.

[6] *In Re*: Cartelization in the supply of EPS Systems, Suo Motu Case No. 07 (01) 2014.

[7] Assessed by the erstwhile COMPETITION APPELLATE TRIBUNAL (COMPAT).

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III. GLOBAL ISSUES

The CCI possesses extraterritorial jurisdiction to inquire into anti-competitive conduct taking place outside India. Section 32 of the Act enables the CCI to enquire into activities having an AAEC in India. The CCI in its investigation of the automobile sector has exercised its extraterritorial powers to investigate global companies and the role of individuals involved in multi-jurisdictional cartels based overseas, that cause an AAEC in India.

Since the establishment of the CCI in 2009, the CCI has increased its collaboration with global antitrust authorities to ensure international co-operation for exposure to best practices, capacity building and knowledge sharing. The CCI has entered into eight Memorandums of Understanding (**MoUs**) with the antitrust regulators of the United States of America (**USA**), Federative Republic of Brazil, Russian Federation, People's Republic of China, Republic of South Africa, Canada, the European Union (**EU**) and Australia. The MoUs facilitate closer competition law co-operation and effective implementation of the law. This collaboration allows the CCI to effectively discharge its duties under the Act by co-operating with its international counterparts on global cartels.

Recently, antitrust regulators across the globe have launched investigations into alleged collusive practices of automobile companies, relating to vehicular emission technologies and standards. The regulation of emission of air pollutants and reduction in greenhouse gas emissions has become stricter with the adoption of stringent standards and emission norms. For OEMs, this translates to higher costs and increased investments in technology upgradation. The European Commission (**EC**)[8] has cautioned German car companies BMW, Daimler and VW AG (Volkswagen, Audi, Porsche) of its preliminary view that they have breached EU antitrust laws from 2006 to 2014 by colluding to restrict competition on the development of technology to clean the emissions of petrol and

[8] The antitrust regulator for the EU.

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diesel passenger cars.[9] The EC found that BMW, Daimler and VW AG participated in a collusive scheme aimed at restricting competition on innovation for two emission cleaning systems and in doing so, denied consumers the opportunity to buy cars with the best available technology.

Similarly in the USA, Department of Justice (**DOJ**)[10] has initiated an antitrust investigation into four OEMs that allegedly forged a deal with the State of California on vehicle-emissions standards.[11] The arrangement between Ford Motor Company, Honda Motor Company, BMW AG and Volkswagen AG was announced in collaboration with the State of California's air quality officials to loosen emission standards and is being investigated on account of alleged cartel implications.

The automobile sector is also witnessing novel alliances amongst automobile companies globally, which is subject to antitrust scrutiny. For instance, Maruti Suzuki India Limited (**Maruti**) of India along with Toyota Tsusho India Private Limited (**TTIPL**) of India, its parent Toyota Tsusho Corporation (**TTC**) of Japan received approval from the EC for acquisition of joint control over a joint venture in India. The joint venture will supply, dismantle and process end-of-life vehicles and market and sell scrap and other products generated from such activities in India. This joint venture was subject to EC's merger control assessment and was unconditionally approved.

Going by this trend of investigations by mature antitrust regulators such as, EU and USA, it is likely that other antitrust regulators will follow suit and initiate similar investigations based on the conduct of such automobile companies in their respective jurisdictions.

[9] Press Release, *Antitrust: Commission sends Statement of Objections to BMW, Daimler and VW for restricting competition on emission cleaning technology,* EUROPEAN COMMISSION (Apr. 5, 2019), https://europa.eu/rapid/press-release_IP-19-2008_en.htm.

[10] The antitrust regulator for the USA.

[11] Andrew J. Hawkins, *Justice Department launches antitrust probe into four automakers around emissions deal with California,* THE VERGE (Sep. 6, 2019, 12:44pm EDT) https://www.theverge.com/2019/9/6/20852839/trump-antitrust-ford-vw-honda-bmw-california-emissions.

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IV. CURRENT ISSUES

India's automobile sector is presently facing a slowdown with dwindling sales and revenue growth. However, it is anticipated that the automobile sector in India is likely to witness foreign investment in the coming years on account of dynamic changes and new developments such as government support through tax cuts.[12] One of the notable features of this sector includes innovative collaborations between OEMs which will enable them to address novel trends in the industry, such as, higher environmental and safety standards, technological shifts, electric and hybrid cars, on-demand rides and autonomous driving. These trends also help in identifying major risk factors that players in the automobile sector must be mindful of in the future.

Recently, the Indian market witnessed collaborations between Toyota Motor Corporation (**Toyota**) and Suzuki Motor Corporation (**Suzuki**). As a part of this collaboration, Toyota and Suzuki would acquire minority stakes in each other.[13] Their cross-holdings would enable the two companies to pool their resources and develop new technologies and enable cross-badging that will permit them to sell each other's products in Indian and overseas markets.[14] Close co-operation between rival firms may potentially result in anti-competitive collusion and companies entering into such innovative collaborations, must be careful to ensure that they are compliant with competition laws in India. The Indian market is likely to witness further collaboration aimed at bringing in innovative mobility solutions to keep up with the increasing importance of ride sharing and radio taxi services.

The Act prohibits anti-competitive agreements between competitors, and such horizontal agreements are presumed to cause an AAEC. Joint venture agreements which increase efficiency in terms of production, supply, distribution, storage, acquisition or control of

[12] Shreya Nandi, *Nirmala Sitharaman says govt working on measures to help auto industry,* LIVEMINT (Sep. 10, 2019, 10:56 PM IST) https://www.livemint.com/politics/policy/govt-to-respond-to-auto-industry-s-demands-says-nirmala-sitharaman-1568106333458.html.

[13] Malyaban Ghosh, *Toyota, Suzuki forge deeper ties by buying stakes in each,* LIVEMINT (Aug. 28, 2019, 11 :28 PM IST) https://www.livemint.com/auto-news/toyota-and-suzuki-announce-capital-alliance-1566982470668.html.

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goods or provisions of services, may be exempt from this presumption. Any collaboration between competitors must demonstrate proved efficiencies in order to be compliant with the provisions of competition law.

V. KEY CASES

5.1. ANTI-COMPETITIVE AGREEMENTS: CARTELS, RESALE PRICE MAINTENANCE; EXCLUSIVE SUPPLY/DISTRIBUTION AGREEMENTS; TYING AND BUNDLING; REFUSAL TO DEAL.

Section 3 of the Act prohibits anti-competitive agreements which cause or are likely to cause an AAEC in India. The CCI has held dealership agreements to be vertical arrangements as the parties (manufactures and distributors / dealers) are at different stages of the production and supply chain and are present in different markets. Horizontal agreement means an agreement between enterprises, each of which operates at the same level in the production or distribution chain. On the other hand, vertical agreements are agreements between firms operating at different levels in the production and supply chain. Unlike horizontal agreements, in the case of vertical agreements there is no presumption of an AAEC.

Vertical agreements are considered anti-competitive only if they cause AAEC in the market. In order to determine whether an agreement results in anti-competitive vertical restraints, the following five essential ingredients must be satisfied:

(i) There must exist an agreement amongst enterprises or persons;

(ii) The parties to such agreement must be at different stages or levels of production chain, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services;

(iii) The parties must be in different markets;

(iv) The agreement should be of the nature as illustrated under the Act; and

(v) The agreement should cause or should be likely to cause AAEC.

[14] Cross-badging or badge engineering is a strategy by OEMs to sell the same car with minor changes in design, etc.

In its prior decisional practice, the CCI held that dealership agreements between manufacturers and dealers/ distributors, are in the nature of vertical agreements as the parties are at different stages of the production and supply chain and are in different markets. With an increase in competition and the number of players, the automobile sector has been subject to scrutiny by the CCI, particularly, issues arising out of the distribution and servicing of motor vehicles and cartel activity in relation to various auto-components.

One of the landmark decisions in the automobile sector, is *Toyota & Ors. v. Competition Commission of India* (**Spare Parts Order**).[15] The CCI held that the practice of requiring dealers to source spare parts only from OEMs or their approved vendors, restricting access to spare parts and diagnostic tools, cancellation of warranty if cars were repaired by independent repairs, amounted to exclusive supply and distribution agreements and refusal to deal under the Act. The erstwhile COMPAT[16] affirmed the CCI's decision. The COMPAT held that the OEMs imposed restrictions through agreements and practices on OES by restricting them from selling spare parts, including technical manuals, diagnostic tools, etc., in the aftermarket, including to the independent repairers, and to the authorised dealers, restricting them from sourcing spare parts from OESs and from selling spare parts to independent repairers thereby refusing to deal with the latter. This amounted to an anti-competitive exclusive supply agreement, exclusive distribution agreement and refusal to deal.[17]

The CCI's decision in *Hyundai Motor India Limited* (**Hyundai**) is another significant decision dealing with vertical restraints. Hyundai was found to be imposing RPM by setting and implementing a 'Discount Control Mechanism' on its dealers through, *inter alia*, mystery shopping agents, as well as tie-in arrangements which mandated that its dealers use recommended lubricants, sell CNG kits and insurance policies and services.

This helps the OEMS to benefit from each other's strengths and increase their product portfolio.

[15] Toyota & Ors. v. Competition Commission of India, 4204 Appeal No.60/2014.

[16] THE FINANCE ACT, 2017 has transferred the appellate functions under the Act to the NCLAT, from the COMPAT, which has ceased to exist effective May 2017.

[17] The matter is currently pending on appeal before the SC.

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This case is the first definitive finding of RPM, where the CCI levied a penalty of INR 87 crores[18] on Hyundai.[19]

5.2. ABUSE OF DOMINANT POSITION

Explanation (a) for section 4 of the Act defines dominant position to mean "*a position of strength enjoyed by an enterprise in a relevant market, which enables it to operate independently of competitive forces prevailing in the relevant market or affect its competitors or consumers or the relevant market in its favour.*" The Act does not prohibit the existence of dominance (i.e., big is not bad) and instead prohibits the abuse of such dominant position.

While determining dominance, the CCI is required to consider the factors listed in Section 19(4) of the Act, including market share of the enterprise, size and resources of the enterprise, size and importance of competitors, economic power of the enterprise (including commercial advantages over competitors), vertical integration of the enterprises or sale or service network of such enterprises, dependence of consumers on the enterprise, etc. Section 4(2)(b) of the Act sets out a list of abusive practices which are prohibited under the Act.

The delineation of the relevant market is crucial in order to first assess whether an entity is a dominant player, and the parameters of abuse of dominance are subsequently assessed within the relevant market. The relevant market includes the relevant product market and the relevant geographic market. In the automobile sector, the CCI has delineated the relevant market to be the "market for manufacture and sale of luxury cars in India"[20]; "market of sports utility vehicles in India"[21]; "market of truck and trailer components"[22]; "aftermarket for spare parts", etc. It has also been held that the

[18] USD 12.06 million.

[19] Fx Enterprise Solutions India Pvt. Ltd. v. Hyundai Motor India Limited, Case Nos. 36 & 82 of 2014. The CCI's order has been set aside on appeal by the NCLAT due to lack of credible evidence and non-delineation of relevant market by the CCI. The matter is currently on appeal before the SC.

[20] *In Re:* Ravi Beriwala v. Lexus Motors Ltd. & Jaguar Land Rover India Ltd., Case No. 79 of 2016.

[21] *In Re*: Ravi Bhushan Sharma v. Toyota Kirloskar Motor Pvt. Ltd., Case No. 92 of 2016.

[22] *In Re*: M/s Amit Auto Agencies v. M/s King Kaveri Trading Co., Case No. 57 of 2013.

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automobile sector can be segmented into four segments, i.e., two-wheelers; three-wheelers; passenger vehicles; and commercial vehicles.

One of the most noteworthy decisions in the automobile sector is the Spare Parts Order,[23] wherein the CCI found 14 car manufacturers guilty of indulging in anti-competitive conduct. In this case, the CCI delineated the relevant market to be the primary market for "manufacture and sale of cars in India" and the aftermarket for "sale of spare parts and repair and maintenance services". The CCI found the car manufacturers to be dominant in the aftermarket for their own genuine spare parts and after-sale services and penalised them for abusing their dominance in this secondary market. The CCI relied upon the initial investment and inability of vehicle owners to switch to competing spare part providers after purchasing a car, to find the OEMs to be dominant in the aftermarket. An aftermarket is a market for a secondary product, i.e., a product which is purchased only as a result of buying a primary product. It was found that a consumer in the primary automobile market is locked in the aftermarket for spares and repair services because a consumer of a particular model of car manufactured by an OEM cannot switch to the spare parts manufactured by another OEM.

The OEMs were found to be abusing their dominance by restricting independent repairers and other non-authorized repairers from accessing the secondary market (aftermarket) and marking up the prices of spare-parts of automobiles. Further, these OEMs did not allow independent service providers access to their spare parts, thus protecting their position in the after-sale services market as well. It was found that the OEMs leveraged their dominance in the relevant market of supply of spare parts to protect the market for after sales service and maintenance, thereby violating the Act. On appeal, the COMPAT affirmed the CCI's finding and held that each of the OEMs were dominant in the market for after-sale repairs and services of their vehicles. They abused their dominant position by imposing unfair conditions by restricting purchase or sale of goods or services from their authorized dealers and OES. The OEMs indulged in denial of market access to independent repairers of automobiles to the spare parts in the

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aftermarket. The OEMs also leveraged their dominant position in the spare parts aftermarket to protect the other relevant market i.e., the repairs and maintenance market. Further, the OEMs had used their dominant position in the spare parts aftermarket to protect their authorized dealers in the repairs and service market for automobiles.[24]
The CCI has, in its assessment of certain other cases, also dismissed various allegations of deficiency in quality and services as consumer cases do not amount to anti-competitive conduct and fall under the ambit of the Consumer Protection Act, 1986.[25]

5.3. COMBINATIONS

The merger control regime in India is governed by Section 5 and Section 6 of the Act and came into effect from 1 June 2011. All acquisitions, mergers and amalgamations that exceed the jurisdictional thresholds under the Act are required to be notified to the CCI.[26]

Under its merger control regime, the CCI has made certain noteworthy observations while assessing the automobile sector. In the case of *ZF Friedrichshafen AG*,[27] the CCI while delineating the market has observed that the automobile industry in India has particularly evolved around three major regions, namely, Mumbai-Pune-Nashik-Aurangabad; Chennai-Bangalore-Hosur; and Delhi-Gurgaon-Faridabad region, since the automobile industry in India is largely present in clusters in these regions with OEMs as centres of growth. In a recent transaction between CK Holdings, Fiat Chrysler Automobile N.V. and Magneti Marelli S.p.A,[28] the CCI observed that the automotive components may be segmented into broad categories such as body electronics, heating, ventilation and air conditioning, human machine interface electronics, lighting,

[23] Shamsher Kataria v. Honda Siel Cars India Ltd. & Ors., Case No. 3 of 2011.
[24] The matter went before the Delhi HC on a constitutional challenge and the order (Mahindra Electric Mobility Limited & Ors. v. CCI, W.P.(C) 11467/2018) clarified the constitutionality of various provisions of the Act and the scope of the CCI's powers.
[25] *In Re*: Akhil R. Bhansali and Skoda Auto India Pvt. Ltd. & Anr., Case No. 44 of 2017; *In Re*: Ravi Beriwala v. Lexus Motors Ltd. & Jaguar Land Rover India Ltd., Case No. 79 of 2016; *In Re*: M/s Shree Hari Inn Pvt. Ltd. v. M/s Mercedes Benz India Pvt. Ltd., Case No. 93 of 2016; *In Re*: Ravi Bhushan Sharma v. Toyota Kirloskar Motor Pvt. Ltd., Case No. 92 of 2016.
[26] The notifiable transactions which satisfy the specified jurisdictional thresholds are known as "combinations" under the Act.
[27] C-2014/10/215.
[28] C-2019/01/639.

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powertrain, suspension, exhaust; and parts for aftermarket. These categories can be further sub-segmented into various modules or components, which can be further classified on basis of type of vehicles, i.e., light vehicles, two wheelers, etc.

VI. HIGH COURT AND SUPREME COURT FINDINGS IN THE AUTOMOBILE SECTOR

In a recent landmark case, the Hon'ble High Court of Delhi (**Delhi HC**), by a common judgment in *Mahindra Electric Mobility Limited & Ors. v. Competition Commission of India & Ors.*[29] disposed of writ petitions filed by car manufacturers challenging the constitutionality of certain provisions of the Act.[30] The Delhi HC held that the revolving door policy of the CCI destroys the right of a fair hearing and violates the basic principle of *"one who hears must decid*e". Guidelines were issued directing that all proceedings shall be heard *en banc,* and no addition or change in members shall be permitted during a final argument in the interest of principles of natural justice. Remarkably, the Delhi HC declared Section 22(3) of the Act as void in entirety, while keeping the proviso intact which mandates a quorum of minimum 3 Members. This was owing to the potential mischief of the casting vote by which the Chairperson of the CCI may tip the balance the other way by his second vote. It was also clarified that the scope and subject matter of investigation can be expanded by the DG.

In the landmark Spare Parts Order[31], Nissan Motors India Private Limited, [32] Toyota Kirloskar Motor Private Limited,[33] and Ford India Private Limited[34] filed an appeal before the SC against the order[35] passed by the erstwhile COMPAT which upheld the decision of the CCI. The SC has granted an interim injunction on the application of the order of the COMPAT and the matter is currently pending disposition. In the Hyundai

[29] W.P. (C) 11467/2018.
[30] Section 22(3), Section 27(b), Section 53A, Section 53B, Section 53C, Section 53D, Section 53E, Section 53F and Section 61 of the Act.
[31] Shamsher Kataria v. Honda Siel Cars India Ltd. & Ors., Case No. 03 of 2011.
[32] Civil Appeal No. 951 of 2017.
[33] Civil Appeal No. 1222 of 2017.
[34] Civil Appeal No. 1054 of 2017.
[35] Appeal No. 62 of 2014.

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case, the CCI has filed an appeal before the SC, against the order of the NCLAT which set aside the order passed by the CCI on the grounds that the CCI failed to appreciate the evidence and that the impugned order was passed merely on the opinion of the DG.[36]

VII. KEY TRENDS

Amongst other investigations, the CCI is currently assessing and investigating two ongoing matters in the automobile sector, against Maruti and Honda Motorcycle and Scooter India Private Limited (**Honda**), respectively, on issues pertaining to vertical restraints and abuse of dominance.

In 2019, the CCI ordered an investigation against Maruti, based on an anonymous e-mail sent by a purported distributor, on allegations pertaining to anti-competitive discount control policy.[37] The CCI *prima facie* found Maruti to be dominant in the market for sale and distribution of passenger cars in India. Maruti was found to be the market leader in the passenger cars segment in India with more than 50% market share in 2017-2018. Maruti indulged in practices to fix the maximum discount which its dealers could offer to end customers, by sending 'Mystery Shopping Audit Reports' seeking clarification from dealers found violating its discount control policy. The errant dealers were penalised for providing additional discounts over and above the permitted level, which was considered anti-competitive and amounted to RPM.

The CCI has also ordered an investigation against Honda[38] against its practices towards unfair restriction of sale of oil, lubricants and batteries, requiring mandatory purchase of accessories & merchandise items, forceful billing of slow moving vehicles, compulsory deduction of advertising expenses, restricting insurance and finance options, making certain purchases contingent upon purchase of booklets from a specific entity, terminating dealerships without prior notice and refusal for stock buyback. Honda was found to be *prima facie* dominant in the market for manufacture and sale of scooters in

[36] Competition Commission of India v. Hyundai Motor India Ltd. & Ors., Civil Appeal No(s). 11250 of 2018.
[37] Alleged anti-competitive conduct by Maruti Suzuki India Limited (MSIL) in implementing discount control policy vis-à-vis dealers, Case No. 1 of 2019.
[38] Vishal Pande v. Honda Motorcycle and Scooter India Private Ltd., Case No. 17 of 2017.

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India, based on sales data and market shares. The supplementary obligations imposed in the Dealership Agreements, by their commercial usage, were found to have no connection with the subject of the contract. Mandatorily requiring dealers to purchase oil and consumables, genuine accessories, advertising services, merchandise items, batteries, insurance and finance options, etc., from designated sources, amounted to anti-competitive restraints. The CCI found that these practices pertained to abuse of dominance, RPM, discount control mechanism, allocation of markets for sale of goods, exclusive supply agreements, refusal to deal and were *prima facie* anti-competitive in nature.

From an Indian antitrust standpoint, the role and conduct of several OEMs and automobile components manufacturers are also being investigated by the CCI for their alleged anti-competitive practices, including their role in global cartels.[39] Notably, under Section 41 of the Act, the CCI, through the DG, periodically conducts "dawn raids" as a part of its investigation into cartel activity. Dawn raids are CCI's evidentiary tool to curb anti-competitive practices through various surprise search and seizure activities, drawing its power to do so under Section 41 of the Act. Documents and materials seized by the DG during such a search can be used as evidence during the inquiry.[40] The DG has conducted six dawn raids across multiple sectors, to collect crucial evidence as a part of the investigative process.[41]

In order to avoid antitrust risks, enterprises in the automobile sector would need to implement robust competition compliance practices tailored to their needs and requirements, conduct internal training sessions, audits, and mock dawn raids to identify potential antitrust issues and take corrective remedial measures.

[39] Veena Mani, *CCI issues 100 notices to auto parts firms to investigate global cartels*, BUSINESS STANDARD (Mar. 5, 2018, 9:40 PM IST), https://www.business-standard.com/article/companies/cci-issues-100-notices-to-auto-parts-firms-to-investigate-global-cartels-118030501169_1.html.

[40] Competition Commission of India v. JCB India Ltd., Criminal Appeal No. 76 and 77 of 2018.

[41] Sectors such as construction, batteries, breweries, food and pulses, railway equipment and tarpaulin manufacturing.

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THE NEGLECT OF RIGHTS IN LAW AND ECONOMICS

- *Mark D. White**

I. INTRODUCTION

The economic approach to law is by any measure the most successful application of the principles of economics to a field outside its traditional focus on markets and their effects on individuals and society. In the half century since the seminal contributions of scholars such as Gary Becker and Richard Posner, economics has influenced the development of law in terms of both statutes and judicial decisions, and has become a thriving field of scholarship in both law schools and economics departments around the world, with numerous volumes and journals (such as this one) published every year.

However, the way that law and economics has developed as a field has troublesome implications for the view of the law it promotes, as well as the policy and legal recommendations it makes. Specifically, law and economics inherited the utilitarian foundations of neoclassical economics and brought them into the study of law itself, to the exclusion of its traditional basis in rights and justice. This influence was hardly resisted: As George Fletcher explains, "the devotee of [law and economics] writes in a long line of theorists who think that all legal institutions should serve the interests of society," transitioning from a focus on individual rights to a theory of legal intervention that permits the periodic redefinition of property rights for the sake of a collective vision of efficiency.

A theory of individual supremacy ends up as a philosophy of group supremacy. This is a remarkable metamorphosis. Any theory that can successfully obfuscate the difference between individual sovereignty in the market and the dominance of group interests in coercive decision making will surely gain a large number of followers.[43]

* Professor and Chair, Department of Philosophy, College of Staten Island/CUNY, and Member of Doctoral Faculty, Program in Economics, The Graduate Center of CUNY: profmdwhite@hotmail.com.

[43] GEORGE P. FLETCHER, BASIC CONCEPTS OF LEGAL THOUGHT 162 (1996).

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As Fletcher indicates, the willing adoption of economic principles on the part of legal scholars implied the gradual removal of the concept of rights from the vocabulary, resulting in a picture of the law that no longer grants individuals a sphere of liberty from which they are protected from welfarist dictates, and renders the individual merely a source of utility who contributes to the whole and therefore is subject to policies and laws designed to maximize that sum total.

In this essay, I detail the background of the utilitarian foundations of law and economics and detail the implications of the neglect of rights resulting from it. I explore its ramifications for the way law-and-economics scholars analyze various legal concepts, focusing on the absence of wrongdoing from the field's analysis of harm as well as the failure to consider the existence of rights that can justify it. I conclude with a cautionary note about the continued neglect of rights in the economic analysis of the law, and suggest initial steps to improve it, ensuring that economic principles can usefully contribute to the study of law at the same time that rights of individuals are acknowledged and respected.

II. UTILITARIANISM AND ECONOMICS

The basic idea of utilitarianism can be traced back to antiquity, but its most well-known and modern exposition is credited to Jeremy Bentham and John Stuart Mill, both reformers who recommended utilitarianism as a tool for social betterment through government policy and law.[44] In their presentation, utilitarianism is a school of ethics focused on maximizing the total happiness, well-being, or *utility* of the members of a group or society. As such, it is a specific form of *consequentialism*, the general term for any ethical system that places moral value on the results or outcomes of actions, rather than the nature of the moral acts themselves (as does *deontology*) or the character of the persons performing them (as does *virtue ethics*).

[44] JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION (1789); JOHN STUART MILL, UTILITARIANISM (1863). For an overview and contemporary perspectives, *see* BEN EGGLESTON & DALE MILLER (EDS), THE CAMBRIDGE COMPANION TO UTILITARIANISM (2014).

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Bentham started his treatise on utilitarianism with the famous passage: "Nature has placed mankind under the governance of two sovereign masters, *pain* and *pleasure*. It is for them alone to point out what we ought to do, as well as to determine what we shall do."[45] This statement could very well have been written about economics in both its descriptive (positive) and prescriptive (normative) forms.[46] In descriptive or analytic terms, economic agents are presumed to make choices that maximize their welfare or utility as represented by preferences: Consumers satisfy their preferences for goods and services, workers satisfy their preferences for income and leisure, and so forth. Even agents representing institutions such as firms and government agencies are assumed to have preferences, either their own (for income, prestige, or power) or on behalf of the institutions they represent (firms have a "preference" for profit, government agencies have "preferences" for their own goals, and so on). In general, mainstream economics assumes that all agents make choices to further their preferences and thereby maximize their utility (itself merely a measure of preference-satisfaction), in the spirit of Bentham's pleasure versus pain determining "what we shall do."

In prescriptive or policy terms, economics even more directly reflects its utilitarian roots in recommending that policymakers act to maximize total welfare or utility. In theory, the goal of welfare maximization can be conceptualized using *social welfare functions*, which aggregate the preference orderings of society's constituent individuals and then find the policies or laws that maximize it.[47] On a smaller, incremental scale, economists look at individual policy or legal proposals and assess the relative amounts of "pleasure" and "pain" generated, a process commonly known as *cost-benefit analysis*. A specific form of cost-benefit analysis widely used in economics (and law and economics) is *Kaldor-Hicks efficiency*, in which proposals are assessed to determine whether the total gains from the change exceed the total losses, even if the gains and losses accrue to different parties. In both its descriptive and prescriptive forms, then, mainstream economics—and therefore law and economics—reflects its utilitarian roots, belying the common belief that

[45] BENTHAM, *supra* note 44, chapter 1.

[46] I prefer the terms *descriptive* and *prescriptive* because they sidestep (to some extent) the debate about the fact/value distinction that complicates discussions of economic methodology. In general, *see* HILARY PUTNAM, THE COLLAPSE OF THE FACT/VALUE DICHOTOMY AND OTHER ESSAYS (2004).

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economics can be value-free and separate from ethics, as well as revealing ethical problems inherent in economics that it inherits from utilitarianism.[48]

We can use Kaldor-Hicks efficiency to show the limitations of utilitarian logic in economics (and law and economics). Suppose a proposed new bridge over a river would benefit some people by $10 million (through improved access and travel times) and harm others by $8 million (through displacement and disruption). This project would be considered Kaldor-Hicks efficient because the "winners" could potentially compensate the "losers" and still be better off (by $2 million). For this reason, Kaldor-Hicks efficient proposals are often called "potential Pareto improvements," invoking the more stringent criteria of Pareto efficiency, by which a policy change has to make at least one person better off without making any person worse off. The difference between the two is key, though: The fact that compensation in the Kaldor-Hicks case is purely potential or hypothetical implies that someone *is* hurt and is not compensated for the harm. This is consistent with utilitarian logic, in which the only relevant measure is total utility, which increases as long as gains exceed losses—as they do by definition in Kaldor-Hicks efficient policies.

Herein lies the main problem with Kaldor-Hicks efficiency: As long as total welfare increases, it matters not whether anybody loses in the process. (Distributional effects are not relevant unless they affect utilities themselves.) In general, utilitarianism fails to acknowledge or respect the "distinction between persons" (as John Rawls called it), giving equal treatment to each person's utility but not guaranteeing that the degree of treatment given to everyone is adequate.[49] Even though each person's utility is considered just as much as any other person's, no one's utility is taken especially seriously, and will quickly be sacrificed if another person's utility can be increased by more.

[47] For more on social choice, *see* AMARTYA SEN, COLLECTIVE CHOICE AND SOCIAL WELFARE: AN EXPANDED EDITION (2018).

[48] For surveys of these problems, *see* J.J.C. SMART & BERNARD WILLIAMS, UTILITARIANISM: FOR AND AGAINST (1973), and SAMUEL SCHEFFLER (ED.), CONSEQUENTIALISM AND ITS CRITICS (1988). On the intrinsically ethical nature of economics, see, e.g., HILARY PUTNAM & VIVAN WALSH (EDS), THE END OF VALUE-FREE ECONOMICS (2012), and MARK D. WHITE (ED.), THE OXFORD HANDBOOK OF ETHICS AND ECONOMICS (2019).

[49] JOHN RAWLS, A THEORY OF JUSTICE 27 (1971).

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This aspect of Kaldor-Hicks efficiency reflects the absence of any meaningful rights to protect persons from takings in the name of total utility. In terms of Kaldor-Hicks, the harms from a policy proposal are not considered as a possible result of a rights violation, but only as a numerical counterweight to the benefits from it, and if the harms are smaller than benefits, the policy is declared efficient and no more thought is given to the parties on whom the harm is imposed. Of course, compensation may be arranged: For instance, if the government claims eminent domain over private land needed for a public project, the landowner is paid the going market rate for her property.[50] However, not only may the payment given be insufficient to compensate the landowner for the value she places on the property, but also, she was denied the right to refuse consent to the transfer in the first place. As Jeremy Waldron wrote, "when we impose a Kaldor-Hicks improvement, we are not in any way honoring the voluntary consent of the losing party."[51] Even if compensation were enough to make up for lost value, this would not be enough to satisfy moral concerns; as Ronald Dworkin recognized, "the fact of self-interest in no way constitutes an actual consent."[52] Consent is necessary to ensure actual well-being is increased, but more importantly, to make sure essential rights are respected.

To get to the heart of the ethical problem with Kaldor-Hicks efficiency, it helps to consider briefly an ethical system often contrasted with utilitarianism: *deontology*, specifically the version developed by Immanuel Kant.[53] In general, deontology judges actions by their intrinsic properties rather than by their consequences in specific cases. For example, most utilitarians regard lying in general to be bad, because the practice usually leads to negative outcomes, but they allow for white lies and "benevolent lies" when they would do more good than harm. Most deontologists, on the other hand, hold lying to be wrong on its face, regardless of effects or intent, because it violates a more

[50] In the United States, eminent domain is increasingly used, not to claim land for public use, but to transfer it to private developers for use that would increase tax revenues, a clear example of Kaldor-Hicks efficiency that not only violates property rights but also the original intent of eminent domain. For more, *see* ILYA SOMIN, THE GRASPING HAND: *KELO V. CITY OF NEW LONDON* AND THE LIMITS OF EMINENT DOMAIN (2015).

[51] Jeremy Waldron, *Nozick and Locke: Filling the Space of Rights*, 22 SOCIAL PHILOSOPHY AND POLICY 81, 101 (2005).

[52] Ronald Dworkin, *Why Efficiency?*, 8 HOFSTRA LAW REVIEW 563, 574 (1980).

[53] For Kant's ethics, *see* ROGER J. SULLIVAN, AN INTRODUCTION TO KANT'S ETHICS (1994) and IMMANUEL KANT'S MORAL THEORY (1989). For more on the relevance of Kant to law and economics, *see* MARK D. WHITE, KANTIAN ETHICS AND ECONOMICS: AUTONOMY, DIGNITY, AND CHARACTER 122–162 (2011). For a more general deontological approach to law and economics, specifically using *threshold deontology* (which allows

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basic moral precept or principle. Kant in particular found lying to be wrong because it uses the persons lied to merely as means to the liar's end and thereby fails to respect their inherent dignity, as demanded in one of the forms of Kant's famous categorical imperative: "act in such a way that you treat humanity, whether in your own person or in the person of another, always at the same time as an end and never simply as a means."[54] In practice, this means abstaining from deception or coercion, both of which deny the other persons meaningful consent in a situation involving them, reducing them to a mere tool used in someone else's plan.

It is in the Kantian context that the shortcomings of Kaldor-Hicks efficiency and the neglect of rights therein reveal themselves most clearly. When a policy is approved that benefits one group of people at the cost of harming another, the persons harmed are literally used as means to the ends of benefiting others.[55] Therefore, as Anthony Kronman wrote, "For a Kantian, the Kaldor-Hicks test has no significance."[56] This offense stands even if compensation is given, because the persons affected were not given the opportunity to deny consent to the policy to begin with. Even the Pareto improvement test, which requires that no one be harmed by a policy change, runs afoul of this Kantian principle when judgments of "better off" and "no worse off" are made by external observers with no information regarding subjective valuations; this provides another reason to object to Kaldor-Hicks harms even when compensation is provided (as with eminent domain takings).[57]

III. THE NATURE OF RIGHTS

To put it bluntly, utilitarianism has no room for rights, which Bentham famously called "nonsense upon stilts," a sentiment with which economists, including those specializing

consequentialist consideration once opportunity costs become sufficiently high), *see* EYAL ZAMIR & BARAK MEDINA, LAW, ECONOMICS, AND MORALITY (2010).

[54] IMMANUEL KANT, GROUNDING FOR THE METAPHYSICS OF MORALS (trans. James W. Ellington) 429 (1785/1993).

[55] Technically, if the end is welfare maximization, then *all* persons affected, whether for better or worse, are used merely as mean to that end.

[56] Anthony T. Kronman, *Wealth Maximization as a Normative Principle*, 9 J. LEGAL STUD. 227, 238 (1980).

[57] *See* Mark D. White, *Pareto, Consent, and Respect for Dignity: A Kantian Perspective*, 67 REV. SOC. ECON. 49 (2009).

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in the law, would certainly agree.[58] Utilitarians support rights only when they make sense on utilitarian grounds; accordingly, many economists support rights of property and contract only insofar as they contribute to the functioning of the market and the generation of economic welfare (as is seen in antitrust law, on which more later), not out of respect for any principles supporting the rights themselves. As Dworkin wrote critically of economists: "The institution of rights, and particular allocations of rights, are justified only insofar as they promote social wealth more effectively than other institutions or allocations."[59] Even when economists defend rights, it is in a way so qualified as to be meaningless. For instance, Posner claimed that economists recognize "absolute rights," but then clarified that "the economist recommends the creation of such rights… when the cost of voluntary transactions is low," concluding that "when transaction costs are prohibitive, the recognition of absolute rights is inefficient."[60] Economists are likely to dismiss an "arbitrary initial assignment of rights" (in Posner's words) that is not grounded in welfare-maximization, but traditionally rights are based on some essential principle grounded in human dignity and liberty, hardly arbitrary outside of utilitarianism.[61]

However, the justification of rights solely on utilitarian grounds defeats the very purpose of rights, which are meant to protect individuals from the demands of utilitarian logic. As Ronald Dworkin wrote in the introduction to his landmark volume *Taking Rights Seriously*:

> Individual rights are political trumps held by individuals. Individuals have rights when, for some reason, a collective goal is not a sufficient justification for denying them what they wish, as individuals, to have or to do, or not a sufficient justification for imposing some loss or injury upon them.[62]

[58] Jeremy Bentham, *Nonsense Upon Stilts*, in RIGHTS, REPRESENTATION, AND REFORM: NONSENSE UPON STILTS AND OTHER WRITINGS ON THE FRENCH REVOLUTION (Philip Schofield, Catherine Pease-Watkin, & Cyprian Blamires, eds, 2002), at 317. On this concept, *see* Schofield, *Jeremy Bentham's 'Nonsense Upon Stilts'*, 15 UTILITAS 1 (2003).
[59] Ronald Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 191, 198 (1980).
[60] RICHARD A. POSNER, THE ECONOMICS OF JUSTICE (2nd ed) 70 (1983).
[61] *Id.* at 98.
[62] RONALD DWORKIN, TAKING RIGHTS SERIOUSLY xi (1977).

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In this sense, rights absolve persons who possess them from being forced to comply with the dictates of utilitarian policy. For the most part, citizens in liberal democracies are free to consume the goods and services they like, pursue the careers they find most personally fulfilling or lucrative, and live where and with whom they want, without being required to make their choices conform with the maximization of total welfare or utility. By the same token, many of the rights granted to the people in the Bill of Rights to the U.S. Constitution protect certain ranges of behavior, such as speech, association, and religious practice, from suppression in the interests of overall well-being (which may be sincerely and significantly affected by them, such as when a racist demagogue on a street corner offends the sensibilities of passersby). All of these choices and behaviors are shielded by rights in the interest of protecting individual liberty from the state's otherwise reasonable and legitimate interest in maximizing well-being.

The conception of rights for which I am advocating is very general and, I hope, one that most readers will find reasonable and familiar. I do not hold to any precise or specific definitions of rights, but rather the sense that Dworkin referred to when he wrote of rights as "trumps," protecting individuals from the demands of utilitarianism, carving out a zone of liberty in which they are free to do as they choose, regardless of the effects of total welfare, provided they respect the same rights of others. The idea of rights I am using is also very broad: It does not specify which rights belong to individuals in a given society or legal system, but merely holds that they have some rights which take precedence over welfare in nontrivial cases. In more liberal societies people generally have more and stronger rights, or wider zones of freedom, although the precise delineation of these rights differs (especially with regard to freedom of speech). It also does not specify how strong rights must be. It certainly does not posit any rights to be absolute; any right, in general, can be overridden by another right, principle, or interest that is judged to be more important in a particular situation. Nonetheless, in order to have any meaning whatsoever, a right must overwhelm the dictates of welfare in some nontrivial cases.

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My intention is to propose a very common and widely held view of rights—not absolute, but with significant ability to stand up to welfarist concerns. This is how most civil rights are considered, including rights to free speech, association, and worship, as well as protections given to members of specific minority groups. Speech can often cause true harm, ranging from "mere" offense to significant emotional distress, which can be quantitatively significant if it affects a large group. The paradigmatic example is the racist spewing filth on a street corner, but it can also apply to a person telling "uncomfortable truths" to an audience who would rather not hear them. Traditionally, the right of free speech, at least in the United States, has been held to be all but absolute, admitting exceptions only in cases of "clear and present danger" and deliberate provocation of violence, and definitely not in cases of more ephemeral harm, this being one of the considerations against which such a right is enforced. Nonetheless, the right of free speech has been increasingly challenged on grounds of harm; for instance, the rise in far-right hate speech in the early 21st century has led to calls for bans or "deplatforming," citing the harm on targeted communities, whose very personhood and right to existence is questioned by such speech.[63]

Nor is the interpretation or enforcement of rights implied to be simple or straightforward, as we can see even with the traditional defense of free speech, which nonetheless admits of exceptions in extraordinary circumstances. In the United States, the Supreme Court and federal appeals courts spend a great deal of time defining, refining, and sometimes overturning rights which, in their original language, every schoolchild and applicant for citizenship learns as simple statements of principle. Typically, however, these rights are not subject to democratic vote; as Dworkin, again, wrote, rights are based on moral and legal principles at the heart of a political and legal system, and should not be subject to the preferences of a shifting electorate.[64] Otherwise, there is the danger of what John Stuart Mill called the *tyranny of the majority*, in which the

[63] *See, e.g.,* ERWIN CHEMERINSKY & HOWARD GILLMAN, FREE SPEECH ON CAMPUS (2017).
[64] *See* DWORKIN, *supra* note 57; for a more recent perspective, see Jamal Greene, *Rights as Trumps?* 132 HARV. L. REV. 28 (2018).

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majority may vote, through perfectly legitimate democratic processes, to take away rights from the minority if these rights are not taken out of democratic control.[65]

IV. RIGHTS IN LAW AND ECONOMICS

Despite their importance to the law in general, rights are neglected in the field of law and economics, where the utilitarian nature of economic logic excludes their consideration. We can see this clearly in what many scholars hold to be the central "axiom" in modern law and economics, the Coase Theorem: Assuming clearly assigned property rights and no impediments to bargaining, parties in a private legal dispute will always come to the efficient resolution.[66] Coase demonstrated brilliantly that, under these circumstances, the identity of the party holding the property right is irrelevant to the efficiency of the solution, which is the primary concern of economists.[67] Furthermore, in the utilitarian context, efficiency (or welfare-maximization) is all that matters, which implies that the assignment of property rights is *completely* irrelevant, ethically as well as pragmatically, regardless of any moral arguments supporting a particular assignment.

This creates a problem when the conditions for the Coase Theorem are not met, particularly when property rights are not well-defined. Suppose, for instance, that one tenant in an apartment building is bothered by the noise from an adjacent apartment, but it is unclear which tenant has the right to control the noise level. Because the property right is not clearly defined, the economic approach to law would recommend that the judge "mimic the market" and assign the right to the tenant who values it the most, based on the reasoning that that tenant would purchase the right from the one who valued it less (were it assigned to them). Although the particular assignment is irrelevant to obtaining the efficient solution once the property right is assigned, the judge "speeds up" the process by vesting the rights in the hands of the party who would end up with it in

[65] JOHN STUART MILL, ON LIBERTY (1859).
[66] Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).
[67] Another point Coase made, which is not sufficiently recognized, is that these ideal circumstances rarely hold, limiting the application of his "main" result and emphasizing the crucial role of property rights and transaction costs. For an in-depth analysis of Coase's work, especially on this point, see STEVEN G. MEDEMA, RONALD COASE 63–94 (1994).

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any case. This accords with the utilitarian orientation to rights, which focuses on their value in terms of well-being, but conflicts with the traditional view of rights that would grant the right to the person with the greater moral claim to them. This need not be a simple determination, but however it would be decided, few outside the field of law and economics would argue that rights should belong to those who value them most rather than those with a valid moral claim.

This neglect of rights is easily seen in Coase's seminal example of trains throwing off sparks that damage nearby crops. Coase presents this—and all private conflicts regarding property—as a case of *reciprocal harm*:

> The question is commonly thought of as one in which A inflicts harm on B and what has to be decided is: how should we restrain A? But this is wrong. We are dealing with a problem of a reciprocal nature. To avoid the harm to B would be to inflict harm on A.[68]

Again, although this describes the situation adequately for the purposes of explaining the irrelevance of which party holds the property right, it fails to acknowledge the plain fact that A (the train) clearly harms B (the crops).[69] Claiming reciprocal causation is, in the words of Talcot Page, to confuse "a physical harm with the effects of a remedy," the latter of which attempts to counteract the former, not stand in parallel with it.[70] Nonetheless, Richard Posner writes that "most torts arise out of a conflict between two morally innocent activities, such as railroad transportation and farming," and asks (in reference to Coase's example): "What ethical principle compels society to put a crimp in the latter because of the proximity of the former?"[71] The ethical principle in question, of course, is a right: in this case, the right of the farmer to the security of his crops against harm from passing trains. It is the neglect of rights in law and economics that contributes

[68] Coase, *supra* note 66, at 2.

[69] As Richard Epstein notes, even Coase's description of the situation recognizes an injurer and a victim, even though the distinction is not germane to his argument. *See* Richard Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151, 165 (1973).

[70] Talcot Page, *Responsibility, Liability, and Incentive Compatibility*, 97 ETHICS 240, 252 (1986).

[71] Richard Posner, *Strict Liability: A Comment*, 2 J. LEGAL STUD. 205, 216 (1973).

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to this refusal to recognize the importance of corrective justice and the enforcement of rights as the basis of tort law (as we will discuss below).

Another way to state the problem of the neglect of rights in law and economics is to point out the absence of the language of *wrongdoing* in favor of *harm*, particularly in the study of tort law. The conflict between the railroads and farmers in Coase's example is stated in terms of the harm done by trains to the crops and, in his view, the reciprocal harm done to the railroad by imposing damages on behalf of the farmers. This frame of reciprocal causation not only denies the established property rights that ground the operation of the Coase Theorem itself, but it also fails to acknowledge the corollary wrongfulness of the railroad's violation of the farmer's property rights.

True to its utilitarian basis, the economic approach to tort law focuses on minimizing the total costs—and, by implication, maximizing welfare, given the absence of benefits—associated with accidents, mainly the costs from harm and costs of precaution. The typical result of such analysis is to recommend liability rules that provide incentive for efficient or optimal precaution, from which point additional precaution would cost more than the resulting savings in harm. As will be familiar from our discussion of Kaldor-Hicks efficiency, this focus on optimal precaution and cost-minimization does not take into account compensation, which is a welfare-neutral transfer between parties; all the matters is that any inefficient harm is deterred. In fact, the identities of the injurer and victim are irrelevant; as with Coase's reciprocal causation, it matters not who harmed whom, only that the conflict itself reveals costs that must be allocated (and ideally prevented going forward).

Opposed to the economic approach to tort law is its traditional conception, based on *corrective justice* as originally described by Aristotle and maintained by many legal scholars today, which focuses on addressing wrongful harm and arranging compensation to "make the victim whole."[72] On this account, the identities of the injurer and victim are of

[72] *See, e.g.,* ERNEST J. WEINRIB, THE IDEA OF PRIVATE LAW (1995); Richard W. Wright, *Right, Justice, and Tort Law*, in PHILOSOPHICAL FOUNDATIONS OF TORT LAW (David G. Owen, ed., 1995); and Mark A. Geistfeld, *Economics,*

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paramount importance as the system of tort law lays out the conditions under which the harmed party can shift their costs onto the party that harmed them.

After causation, the most basic condition for tort liability is that the injurer harmed the victim *wrongfully*, in violation of a right not to be harmed. When Aristotle wrote about corrective (or "rectificatory") justice, he argued that the law concerns itself with "the distinctive character of the injury, and treats the parties as equal, *if one is in the wrong and the other is being wronged*, and if one inflicted injury and the other has received it."[73] As modern tort theorists John Goldberg and Benjamin Zipursky explain:

> Tortious wrongdoing always involves an interference with one of a set of individual interests that are significant enough aspects of a person's well being to warrant the imposition of a duty on others not to interfere with the interest in certain ways, notwithstanding the liberty restriction inherent in such a duty imposition.[74]

Jules Coleman and Arthur Ripstein argue that the causation of harm is not sufficient for a tort claim, but some element of wrongfulness must exist based on violation of right or dereliction of duty, "an analytically prior account of what each of us owes one another."[75]

This necessary element of wrongfulness in tortious harm is completely absent from the economic approach that takes the existence of harm itself as sufficient to merit attention.[76] This shortcoming is evidenced by the way law-and-economics scholars—and economists in general—conceive of externalities, the problem that inspired Coase's

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Moral Philosophy, and the Positive Analysis of Tort Law, in PHILOSOPHY OF THE LAW OF TORTS (Gerald J. Postema, ed., 2001).

[73] ARISTOTLE, NICOMACHEAN ETHICS 1132 (350 BCE), emphasis mine.

[74] John C.P. Goldberg & Benjamin C. Zipursky, *Torts as Wrongs*, 88 TEX. L. REV. 917, 937 (2010).

[75] Jules L. Coleman & Arthur Ripstein, *Mischief and Misfortune*, 41 MCGILL L. J. 91, 96 (1995). See also Mark Geistfeld, who writes that "what one has lost for purposes of legal analysis depends on what one was legally entitled to in the first instance," in *The Tort Entitlement to Physical Security as the Distributive Basis for Environmental, Health, and Safety Regulations*, 15 THEOR. INQ. LAW 387, 394 (2014).

[76] Elsewhere, Richard Posner writes that "most common" meaning of justice is efficiency: "When we describe as 'unjust' convicting a person without a trial, taking property without just compensation, or failing to require a negligent automobile driver to answer in damages to the victim of his carelessness, we can be interpreted as meaning simply that the conduct or practice in question wastes resources," in *The Economic Approach to Law*, 53 TEX. L. REV. 757, 777 (1975), emphasis mine.

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analysis in the first place. His paper "The Theory of Social Cost" was a response to the standard economic response to externalities, Pigouvian taxes, which raise private cost to equal social cost, thereby realigning private incentives with broader utilitarian concerns. The paradigmatic example is pollution, in which private polluters have little incentive (absent intervention) to limit emissions given the lack of property rights over shared natural resources such as air and water (which also make impossible straightforward application of the Coase Theorem).

But not all cases of externalities are so thorny, nor do all involve wrongfulness in addition to harm. Some harms result from unremarkable social interaction in the context of scarcity, such as two employees competing for a promotion, or conflicting tastes and preferences, such as a homeowner who takes insufficient care of his lawn and offends his neighbors (possibly lowering their property values). In each of these cases, one party is causing harm to another, but in the absence of rights violations, there is no justification for official action to "correct" it. (The irate neighbors may have a nuisance claim, but this would imply a rights violation that would justify legal action to address the harm.) Even a more serious case of externality such as traffic congestion, in which drivers entering the highway during rush hour fail to consider their impact on their fellow drivers, is a simple case of overuse of a scarce resource, but one involving no wrongdoing. In many jurisdictions, congestion taxes have been the Pigouvian solution, with the Coase Theorem rendered inoperable by the impossibility of bargaining among countless anonymous commuters. But the more significant ethical issue with congestion taxes is there is no wrongful action or rights violation to be addressed: No driver has a right to a certain commuting time, and has no claim against an additional driver who adds to it. Policymakers are clearly acting in the spirit of utilitarianism to optimize congestion costs, but in doing so they are penalizing action that is not wrongful (which also may fall disproportionately on the poor and those unable to shift their commute times).

The common feature among all three examples is the absence of clear wrongdoing that is necessary to justify addressing what is otherwise merely incidental harm. Only in the case of the negligent homeowner might there be a legitimate nuisance issue that would justify

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official action to address the harm, reflecting the necessary presence of wrongdoing to merit addressing harm. Economists, including legal economists, focus on harm without considering if it needs to be addressed at all, but not all harms require attention because not all harms are wrongful. Furthermore, those that are wrongful—such as the trains throwing sparks on nearby crops—fall under the purview of the tort system, which is designed to address such situations based on the wrongfulness evidenced, and renders the economic analysis irrelevant, all for a neglect of rights. In other words, externalities that are wrongful can usually be handled in the courts under tort law that developed for precisely that purpose, and externalities that are not wrongful are of no concern to law or policy, leaving little room for economists to be concerned with them at all.[77]

Not only do many harms occur "innocently," without wrongdoing, but many harms result from the legitimate exercise of rights, such as the actions protected by civil rights, including the rights to free speech, worship, and assembly, even if they cause serious offense or disruption. In terms of the examples given above, eligible employees have the right to compete for a promotion, even if only one earns it and thereby harms the ones who did not. (No economist would challenge this kind of externality, but only because competition in general promotes efficiency, not out of recognition of any right to compete.) By the same token, a homeowner has a right to maintain his lawn (or paint his house, and so on) as he chooses, even if it is regarded as unsightly by his neighbors, unless it is legally determined to be a nuisance (rendering the conflict a case of one right conflicting with another, rather than a right being suppressed merely for the sake of utility or welfare). And certainly commuters have the right to use the roads in a lawful fashion, even if they impose time costs on other drivers; although congestion taxes do not deny drivers this right, they do place a burden on the exercise of it (adding to the existing time burden they voluntarily if resentfully endure).

Perhaps the most significant case of harm addressed in the absence of wrongdoing is antitrust law—which could be considered the "original" law and economics—in which firms are held responsible for business practices, such as collusive price fixing and

[77] For more on externalities and the distinction between harms and wrongs, *see* Mark D. White, *On the Relevance of*

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mergers that result in an overly concentrated industry, that harm consumers, chiefly through higher prices. Although the harm is unquestionable and can be quite large, it is very difficult to claim that any consumer's rights are violated by these actions: Consumers are not normally understood to have a right to a certain (low) price, especially when a firm can raise prices unilaterally, with the same effect on consumers, while facing no legal challenge. Furthermore, the behavior forbidden by antitrust can be considered a legitimate exercise of business owners' property rights, particularly the right of disposal, as well as the right to enter into mutually agreeable contracts with customers and other firms. Seen this way, antitrust law finds its justification solely in utilitarian logic, with no basis in rights violations on the part of harmed parties and, more important, in direct violation of the rights of those targeted.[78]

V. CONCLUSION

With its utilitarian focus on costs to the exclusion of deontological factors such as rights, law and economics sees every problem as harms to be optimized without considering that they may also represent wrongs to be corrected. This has important rhetorical effects in cases such as pollution, an externality that involves both tremendous harm as well as blatant wrongdoing, even in the absence of clearly defined property rights, according to what Mark Geistfeld calls an "underlying entitlement to physical security."[79] Any economics or law professor who has explained that cost-minimization requires optimizing pollution rather than eliminating it is familiar with the disbelieving looks from students who cannot understand why a moral wrong would be tolerated by design (rather than by necessity).

The neglect of rights also shows up in many other areas of law and economics. For example, a central concept in the economic approach to contract law is *efficient breach*, by

Wrongfulness to the Concept of Externalities, 5 ŒCONOMIA 313 (2015).

[78] For more, *see* Richard A. Epstein, *Private Property and the Public Domain: The Case of Antitrust*, in ETHICS, ECONOMICS, AND THE LAW: NOMOS XXIV (J. Roland Pennock and John W. Chapman, eds, 1982); ADI AYAL, FAIRNESS IN ANTITRUST: PROTECTING THE STRONG FROM THE WEAK (2014); and Mark D. White, *On the Justification of Antitrust: A Matter of Rights and Wrongs*, 61 THE ANTITRUST BULLETIN 323 (2016).

[79] Geistfeld, *supra* note 75, at 389.

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which expectation damages align the incentives of the party intending to breach with the total costs in the situation (much like a Pigouvian tax), rendering any decision to breach efficient from the point of view of total welfare. But this analysis excludes any nonfinancial basis of complying with an agreement, such as promise, consent, or autonomy—in other terms, the right of both parties to enforce the agreement and compel performance.[80] This is recognized by the doctrine of *specific performance*, which can also lead to efficient breach through negotiation (based on the Coase Theorem), but enforcing performance is seen by many scholars and judges alike as needlessly coercive and to be avoided if possible.[81] As Oliver Wendell Holmes, Jr., who can be considered an early law-and-economics scholar in spirit, wrote, "The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, - and nothing else."[82] This utilitarian perspective on contracts neutralizes the heart of the concept and renders agreements meaningless; without a meaningful right or duty created by the agreement, contracts are merely transactions, economics at its simplest.[83]

This, ultimately, is the crux of the problem with the neglect of rights in law and economics: Because rights are integral to the law itself, determining legal duties, wrongs, and their appropriate remedies, their exclusion from law and economics leaves only the economics and its utilitarian foundations, to be applied to legal concepts without appreciation of their morally rich nature. When that happens, as Fletcher suggested in the passage quoted at the beginning of this essay, persons stop being distinct individuals and become anonymous, interchangeable contributors to total utility. To mainstream law and

[80] On contract as promise, *see* CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION (1981); on contract as consent, *see* RANDY E. BARNETT, THE OXFORD INTRODUCTIONS TO U.S. LAW: CONTRACTS (2010); and on contract as choice (reflecting autonomy), *see* HANOCH DAGAN & MICHAEL HELLER, THE CHOICE THEORY OF CONTRACTS (2017).

[81] *See, e.g.,* Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 MICH. L. REV. 1349.

[82] Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897).

[83] And the less said about the economics of crime the better, a field in which theft is regarded as inefficient because it draws resources from productive to protective uses, rather than a wrongful violation of property rights, and sexual assault is rationalized as a response to missing markets in sexual services rather than a perverse violation of rights to bodily autonomy and security. As Jules Coleman wrote, "such a theory has no place for the moral sentiments and virtues appropriate to matters of crime and punishment: guilt, shame, remorse, forgiveness, and mercy, to name a few. A purely economic theory of crime can only impoverish rather than enrich our understanding of the nature of crime," in *Crime, Kickers, and Transaction Structures*, in CRIMINAL JUSTICE: NOMOS XXVII (J. Roland Pennock & John W. Chapman, eds, 1985), at 326. This critique goes far beyond the refusal of law and economics to recognize rights and wrongfulness, but it shows that the problem such neglect poses for the study of private law is only the beginning.

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economics, justice is reduced to efficiency and rights to utility, but at what loss? If persons are to have any shield of liberty against utilitarian policy, rights must be "taken seriously," lest the law become a tool of the subordination of each to the goals of the whole—or the few who determine them.

The only question remaining is how to incorporate rights into law and economics, given its current utilitarian and quantitative orientation? This makes necessary a revision to the mathematical nature of the discipline, acknowledging absolute limits to some optimization problems that resist marginal trade-offs, and eliminating the consideration of optimization when it is judged inappropriate. Optimization is still valuable within the bounds of law as defined by rights, and it can even inform decisions on the margins of rights or when they point to opposite conclusions. Apparently irreconcilable conflicts between principles, rights, or duties, all of which resist consequentialist logic, *can* be made using consequences if there is no deontological basis on which to make a decision.[84]

There is still plenty of room for economic logic in the study of law, but it must operate alongside the more crucial concept of rights. To the extent the law is supposed to protect individuals, rights are essential, and any economic approach that neglects them is abandoning this responsibility in favour of utilitarian social engineering.

[84] For more discussion, *see* Mark D. White, *Pro Tanto Retributivism: Judgment and the Balance of Principles in Criminal Justice*, in RETRIBUTIVISM: ESSAYS ON THEORY AND POLICY (Mark D. White, ed., 2011), and *Judgment: Balancing Principle and Policy*, 73 REV. SOC. ECON. 223 (2015).

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ECONOMIC RIGHTS: ISSUES & SUGGESTIONS WITH REFERENCE TO CONSTITUTIONALIZATION, ADJUDICATION & POLICY MAKING

- *Palak Jain**

I. INTRODUCTION

The Economic Darwinism in the past three centuries has resulted in a significant increment in the desires and needs of an industrial man. However, the existing system has failed to create means to address them. In such scenarios of increasing failure of systems to address the needs and desires of people, if the law has to act as 'a system of social engineering', it is essential that it creates a framework to eradicate social frictions by providing dignity through authority of rights.

Rights are most commonly defined as legal, ethical, normative or social principles and basic rules about what is allowed to people, or what they are entitled to according to some legal, social, theological, or ethical systems.[85] With the evolution of civilizations and mankind, it is steadily being concluded that in order to secure a dignified life, it is essential that certain basic inalienable human rights are addressed and upheld by the State.

In the evolution of these human rights, while initially the primary focus was on civil and political rights, the second generation has advanced to addressing the social, cultural and economic rights and finally the third generation i.e. minority rights have also become a pertinent topic of discussion in the realm.[86] The author focuses on the second generation of human rights, i.e. socio-economic rights. The term socio-economic rights have become so common, that often it is assumed that social rights and economic rights are interchangeable.

* Palak Jain is a third year student of law at Institute of Law, Nirma University.
[85] Mohamed Reza Sarani et al. *The Concept of 'Right' & Three Generations,* 5INT'L. J.SC. S,July 2017,451, 455.
[86] *Id.*

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The Constitutions of numerous countries, with special reference to India have granted the economic rights to its citizens, as if a term *in vogue*. However, the reach of such rights to the stakeholders remains doubtful. The author seeks to analyze the existing literature on economic rights and the debate surrounding the issue in Part I. Further, it is also essential to understand the stand-point of Judiciary of India in addressing economic rights violation of the citizens. A pertinent question must be raised, as to the manner of redressal of such economic, the justiciability of such rights in case of state actions and adequacy of directive principles in such redressals. Finally, it is often observed that bringing and enforcing economic rights through policy-making often proves to be a futile and tedious task. The author aims to investigate the problem linked with such enforcement through policy-making from a political perspective. On the basis of these studies, the author concludes the existing state of economic rights in India and suggests corrective measures that can be adopted by the policy-makers for upholding the economic rights of the citizens in a true sense

II. ECONOMIC RIGHTS – LIMITATIONS OF THE EXISTING LITERATURE

2.1. MEANING & SCOPE OF ECONOMIC RIGHTS

The term 'economic' rights is often used to describe rights that are essential to sustain a 'dignified' life. For instance, while right to life and personal liberty shall constitute a civil or political right, a right to education is necessary to ensure that right to life is enforced in a dignified manner. Many scholars have distinguished the study of rights into three generations – first generation, comprising of civil and political rights, second generation comprising of social, cultural and economic rights, and third of minority rights.[87]

2.2. EXISTING DEBATE

2.2.1. Classification of Rights

[87] Pierre Elliott Trudeau, *Economic Rights*, 8 McGill L. J. 121 (1962).

In the recent times, this classification of rights has been called into question. It is also often examined if the social, cultural and economic rights can be at all referred as a single term as indistinguishable from one another.[88] It is also argued that it conceals different patterns of national development that exist.[89] The debate also questions the justiciability of the economic rights and their difference when compared with the first generation of rights.[90]

The Covenant of Economic, Social and Cultural Rights[91] recognized rights such as that of right to strike, right to enjoy just and favorable conditions, right to social security etc.[92] These rights were however not clearly categorized into straight-jacket compartments. It is often observed that the securng a particular form of economic rights, leads to further acknowledgement some or the other form of social or cultural right or vice-versa.

For instance, providing adequate housing rights will automatically lead to social acceptance and fulfillment of allied rights. In fact, when the fulfillment of economic rights is to be compared among different countries, Human Development Index (HDI) and Physical Quality of Life Index (PQLI) are such indices that take into consideration factors such as social and cultural inclusion.

2.2.2. Economic Rights vis-à-vis Right to Property

The term 'economic' is defined as the study of production, consumption, transfer of wealth and most importantly material prosperity.[93] It is often assumed that a literature of economic rights is centered around possession of property. There are two fallacies associated in making such assumptions. *Firstly,* even if assumed but not conceded, that property is the center of discussion for economic rights, while the Universal Declaration

[88] ASBJORN ELDE & ALLAN ROSAS, ECONOMIC, SOCIAL & CULTURAL RIGHTS: A TEXTBOOK 3-5 (Kluwer Academic Publishers 2nd ed. 2001).
[89] *Id.*
[90] Martin Schenin, *Economic & Social Rights as Legal Rights*, ECONOMIC, SOCIAL & CULTURAL RIGHTS: A TEXTBOOK 29-54 (7TH ED. 2013).
[91] International Covenant on Economic, Social and Cultural Rights, adopted on Dec. 16th, 1966.https://www.ohchr.org/en/professionalinterest/pages/cescr.aspx, last visited on Jun. 10th, 2019.
[92] *Id.* art. 6-15.

of Human Rights acknowledges economic right as a human right, neither the Civil and Political Rights Covenant, nor the Covenant on Economic, Social and Cultural recognizes the right to property. *Secondly,* the interpretation of property must include good that an individual must dispose, including labor and personal capacities.
Thus, a denial of any economic right would mean deprivation or impairment of any personal capacity which can be viewed as property. However, this implies that interpretation has to be given in the broadest of sense and thus the 'lawyer's understanding' of a property shall not be sufficient. The interpretation must be as wide as to include right to control sexual behavior.[94]

However, the opponents of this school of thought perceive such an interpretation of economic rights as social. The issue as to what is the center point of economic rights has two opposing views – one that favors the market-based approach for securing wealth, collective liberty etc., whereas the other view has a more legal approach, that believe in fulfillment of economic rights by way of authority through the Constitution.

Therefore, these are some of the voids and debates in the existing understanding of the economic rights. The author has restricted the scope of this article to the consideration of economic rights through a legal approach and not analyzed existing scenario from the free-market perspective.

III. CONSTITUTIONALIZING THE ECONOMIC RIGHTS

3.1. CONSTITUTIONAL LAW & ECONOMICS

As stated in the Universal Declaration of Human Rights, economic rights, which in its umbrella term encompasses a vibrant set of rights, including the right to standard of living, the right to employment, the right to food etc can be achieved through a number of ways. While some may favor achievement of such rights through absolute forces of

[93] Merriam Webster Dictionaryhttps://www.merriam-webster.com/dictionary/economic, last visited 10:14 PM June 15th, 2019.

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market, while others may advocate the lobbying for allocation of higher budget while still others and most commonly advocate for the method of constitutionalizing by way of legal recognition of such rights.[95] As a result of this constitutionalizing process, the government is obligated to ensure that the economic rights are fulfilled. In a study done by Lanse Minkler, the empirical relation between governmental effort and constitutionalizing economic rights is determined, which shall be referred subsequently.

It is often argued by the opponents of the constitutionalizing group that such an approach leads to proliferation of rights at best and in fact dilutes the Constitution with rather unachievable goals. Such constitutional process and effort if directed elsewhere would produce greater and more certain results, opponents argue. In a study of 165 constitutions, wherein 116 constitutions made references to right to education, it was revealed that they were seen as a mere duty of the government,[96] thereby resulting in narrow difference between the understanding of a human rights activist and that of an economist.

3.2. STANDARD OF LIVING & ROLE OF THE CONSTITUTION

In several studies, the degree of validity of constitutional law in understanding the difference among people have been addressed and further whether giving constitutional legitimacy to the rights would solve the problem[97] (Frank Michelman).

Two important studies exist, namely that of Mwangi Kimneyi and David Cingranelli & David Richards which compares economic rights fulfilment and government efforts in consideration with Directive Principles through Human Development Index (HDI) and Physical Quality of Life Index (PQLI). Both these scores pertain to issues other than

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[94] TRUDEAU, *supra* note 87.
[95] Lanse Minkler, *Economic Rights and Political Decision Making*, 31 HUM. RTS. Q. 368 (2009).
[96] Varun Gauri, *Social Rights and Economics: Claims to Health Care and Education in Developing Countries,* 32 W.D.L. REV. 465, 466 (2004).
[97] Jack M. Balkin, *Respect-Worthy: Frank Michelman and the Legitimate Constitution*, 39 TULSA L.REV. 485 (2004), 485-86.

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GDP, such as standard of living, birth rate, employment rate etc. which are directly related with a country's income.[98] It compares and ranks 173 nations.
As per this study, ratings were given according to the economic rights conferred to the citizens by the Constitution. While rating 3 denotes weak or no provisions, 2 denotes fewer provisions and 1 denotes maximum rights protection.

Despite India's robust claim of longest Constitution, it failed to secure any top ratings or rankings in this study. The top ranked constitutions provided rights such as that of adequate housing, employment, etc. and more importantly that to a form of social security. The study highlights the need to give higher importance to standards of living beyond mere non-justiciable directives and the need for an explicit conferment of right under the Constitution for better protection.

3.3. NEED FOR INCORPORATION OF JUSTICIABLE ECONOMIC RIGHTS UNDER THE CONSTITUTION

3.3.1. Directive Principles & Constituent Assembly Debate

With respect to the Constitution of India, the importance of these economic rights was understood and thus imbibed in various forms through Preamble, DPSP and other such constitutional rights and duties. It is intriguing to note that while on one hand, the economic rights are enforceable merely as a general duty of the administration under DPSP, on the other hand, that very directive principle utilize articulation of 'rights'. For instance, Art. 39(a) lays down the State's Obligation to ensure 'right' to satisfactory means of livelihood etc.

Even at the time of drafting of this constitution, while it was generally accepted by the Constituent Assembly members that DPSPs were general principles of administration, debates arose over the justiciability of such principles.

[98] David Beetham, *What Future for Economic and Social Rights?* 43 POL. STUD. 41 (1995).

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The Preamble of the Constitution of India recognizes Economic Justice. However, the Constituent Assembly did not recognize any economic right as a part of fundamental rights. A reading of the Constituent Assembly Debates highlights the questions raised for non-justiciability of economic rights. It was questioned that will it not be arbitrary to draw a distinction between justiciable rights and social and economic rights.[99] Even the rights that have been acknowledged by the Constitution, were followed by a proviso.

3.3.2. Justiciability – Needs, Requirements & Possible Solutions

It is essential that a minimum standard of living is provided under the Constitution as an obligation of the government to secure. Considering the demographics of India, it is plausible to argue that 'such a recognition would be a mere breeding ground for rights which will have no effect reality.'[100] However, as Albie Sachs argues, there are some rights which cannot be held dependent upon government resources and efforts.[101]

As argued in the subsequent sections, as a policy-maker there are instances of giving into populist policies in order to claim credit while still in office. Acknowledgement of such an obligation on the part of State and right of the people under the Constitution will ensure that such errors are minimized.

By such a contention, the author does not mean to argue for making all forms of remote economic rights justiciable. The author argues that of the pool of rights, there are certain unqualified rights, which cannot be waited upon to be progressively realized depending upon the government's resources.

One of the possible way-outs for essential social or economic rights, consider the example of expensive medical treatment can be 'rationing of resources'[102] in a fair and rational way by reasonable utilization of what is available. It is the duty of the executive

[99]Vol. IV Constituent Assembly Debate 265-297.
[100]Terence Daintith, *The Constitutional Protection of Economic Rights*, 2 INT'L J. CONST. L. 56 (2004).
[101]Albie Sachs, *Enforcement of Social and Economic Rights*, 22 AM. U. INT'L L. REV. 673 (2007).
[102]*Id.*

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and legislature, and not judiciary to form standards of determination of such rationing and judiciary acting as a watchdog.

A Constitution that permits the judges to raise questions for securing the rights to the people which are inalienable will not only raise our rank in such indices but also lead to a faster security and effective policy-making. In the absence of such provisions, the judiciary has resorted to the interpretation of the already granted fundamental justiciable rights. With the advancement of judicial understanding and interpretation in the Nation, the current discussion of these DPSP and economic rights have changed over time and have been dealt with in the subsequent section.

IV. JUDICIAL TENDENCY REGARDING ECONOMIC RIGHTS IN INDIA

4.1. ECONOMIC RIGHTS – KEY TO UPHOLD CIVIL & POLITICAL RIGHTS

The Supreme Court, which owes its existence to the Constitution[103] has been granted an original jurisdiction under Art. 32 of the Constitution. As a result of powers under judicial review, the Indian Judiciary has indulged itself in not only interpreting the law, but also making it.[104] While on one hand, judiciary was being viewed as the 'arm of social revolution', on the other hand, there was resistance among the Constituent Assembly Members in granting the power of judicial review. It was feared that judiciary would impair the legislative and executive actions under the garb of upholding the rights.

In the case of *Francis Coralie Mullin v. Union Territory of Delhi*[105], the Supreme Court extended the right to life and personal liberty under Art. 21 to include a right to human dignity and not mere animal existence.[106] From being viewed as a hurdle in furthering the

[103] INDIA CONST. art. 124, cl 1.
[104] MALCOM LANGFORD SOCIAL RIGHTS JURISPRUDENCE: EMERGING TRENDS IN INTERNATIONAL AND COMPARATIVE LAW 102-125 (Cambridge, Cambridge University Press 2008), *See Also* Madhav Khosla, *Making Social Rights Conditional: Lessons from India, 8* Int'l J. Const. L. 739-765 (2010), Gautam Bhatia, *Directive Principles of State Policy: Theory and Practice.*
[105] Francis Coralie Mullin v. Union Territory of Delhi, (1993) 1 SCC 645(India).
[106] *Id.*

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goals of legislation to playing an important role in ensuring the economic development, the judiciary has come a long way.

As a result of this interpretation, the judiciary not only marked the existing refinement of civil and political rights, but in fact, made the economic rights a key to uphold the civil and political rights. This was done in the process of making the second generation economic right enforceable in a court of law, by regarding it an importance, so pertinent as that of right to life. This, in turn, demolished the conception of economic rights as negative rights and resolved the dependency over ideas such as that of laissez-faire and free market.

The Supreme Court further went on to acknowledge various other rights, such as that of food[107], education[108], shelter[109], medical and health aid[110] etc. as justiciable socio-economic rights, which were only at the peril of administrative action and non-justiciable by reason of being a directive principle.

In the case of *Bandua Mukti Morcha v. Union of India*[111]the Supreme Court reiterated the importance of human dignity and basic necessities of life[112] and re-placed the economic right on an equal pedestal with the civil right. Yet again in *Sodan Singh v. New Delhi Municipal Corporation*[113], availability of legal choices were seen by the court as the advancement and acknowledgement of fundamental rights.

In order to achieve this accomplishment, the Supreme Court significantly depended on the Part III, precisely Art. 21 of the Constitution instead of the complicated, unenforceable and non-justiciable language under Art. 37. The right to life thus includes a right to a life of dignity, and thus many directive principles become enforceable.

[107] PUCL v. Union of India (2002) 3 S.C.R. 294 (India).
[108] Unni Krishnan v. State of Andhra Pradesh (1985) 3 SCC 545(India).
[109] Olga Tellis v. Bombay Municipal Corporation (1996) 4 SCC 37(India).
[110] Paschim Banga Khet Mazdur Samiti v. State of West Bengal(1996) AIR SC 2426 (India).
[111] Bandua Mukti Morcha v. Union of India, (1997) 10 SCC 549 (India).
[112] *Id.*
[113] Sodan Singh v. New Delhi Municipal Corporation, 1989 SCR (3)1038(India).

4.2. INDIVISIBILITY OF HUMAN RIGHTS

The South African Philosophy talks about the concept of *ubuntu. Ubuntu* literally means mutual acknowledgement of humanity and interdependence.[114] A similar conception of *ubuntu* is required to be acknowledged with respect to the human rights. Human rights are indivisible.[115] These rights are such that one right cannot be indivisible from another. A right to adequate housing cannot be separated from a right to human dignity. Moreover, it would be a gross violation of fundamental right to deny dignity due to financial incapacity of an individual.[116]

The judiciary does not certainly have the authority to define the policies of the government or intervene with the powers and functions of the executive or legislation. However, in the light of these indivisible rights, as an authority responsible for the protection of rights, it has the responsibility of demarcating a degree of reasonableness in the policies of government.

Therefore, the Judiciary of India has played a significant role in protecting the human rights in absence of justiciability of the economic rights in the light of constitutional values and principles. In the context of future, an important question before the Court is to determine to what extent limitation of resources can be a 'reasonable' ground for not being able to uphold the rights of citizens. It is for the State to demonstrate in such situations that reasonable action is being taken to fulfill its obligation.

4.3. MODIFICATION IN ADJUDICATION MECHANISM

The Jurisprudence developed by the Indian Supreme Court is of much reference around the world when it comes to the enforcement of socio-economic rights. As referred above, the case-laws decided by the Supreme Court have extended strong constitutional

[114] Dikoko v. Mokhatla 2007 (1) BCLR 1 (CC) at 33-36 (S. Afr.).
[115] USHA RAMANATHAN, IN THE NAME OF THE PEOPLE: THE EXPANSION OF JUDICIALPOWER, IN THE SHIFTING SCALES OF JUSTICE: THE SUPREME COURT IN NEOLIBERAL INDIA 156 (3RDED. 2014).
[116] Uday Shankar, *Setting Socio-economic Rights in the context of Human Dignity in India* 8 RMNLU L. J.20 (2016).

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protection to socio-economic rights both in terms of jurisprudential understanding as well as the quantum of cases.

With the development of doctrines such as that of continuing mandamus, which allows the Court to intervene periodically to check-upon the implementation of the judgements stultify the enforcement of economic rights, the Courts have expanded the scope of rights. However, it has also been observed that such decisions are often reduced to annuity by other organs of government.

A Study published in the Hong-Kong Law Journal suggested that apart from the Supreme Court giving decisions, National Human Rights Commission (NHRC) must be entrusted as the implementation-overseeing authority given the powers it has in accordance with the Protection of Human Rights Act 1993.[117]

The appointment of NHRC Chairperson is a governmental function. The post of Chairperson is held by a retired Chief Justice of the Supreme Court.[118] Numerous cases have surfaced of 'safe actions' taken by judges considering the post-retirement plans. Hence, making NHRC the only overseeing authority may not serve the purpose entirely. The role of NGOs must be expanded by framing guidelines to ensure that the decisions rendered by the Courts are effectively implemented. Suggesting a well-planned out mechanism for the same is beyond the scope of this article.

V. ISSUES RELATING TO POLICY ENFORCEMENT OF ECONOMIC RIGHTS

Every country varies in terms of the history, structure of society, culture and pertinent socio-economic issues. This difference often explains the varying approach adopted by different nation-states to resolve their economic problems. As stated earlier, while some address the economic problems by way of free market, others approach them by way of

[117] Rohan J. Alva, *Continuing Mandamus: A Sufficient Protector of Socio-Economic Rights in India*, 44 HONG KONG L.J. 207 (2014).
[118] The Protection of Human Rights Act 1993, § 3(2)(a), No. 10, Act of Parliament, 1994 (India).

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lobbying for higher budget. Another approach is by constitutionalizing either as rights or as directive principles.

5.1. POLICY V. PERK – A POLICY MAKER'S PROBLEM

Lanse Minkler in his analysis distinguishes between policy and perks as the manner of diversion of perks.[119] The funds received through tax (T) and foreign aids (F) can be utilized in primarily two manners- either for implementation of policy, such as public employment, increasing literacy level, developmental goals etc., or as perks that are furthering of self-interest of the policy-maker. The price of perks (u) if low, denotes relative ease in diversion of funds to fulfill self-interest of the policy-maker. On the other hand, a high price of perk denotes difficulty in creating such a diversion.

The job of a good policy maker in this scenario is to maximize the Utility Index (U). If a policy x yields more utility and a policy y yields less utility, finally the marginal benefit/marginal cost ratio is equalized. In order to maximize this ratio, it is necessary that the policy-maker determines the amount and efforts required in optimization.

In order to create more optimization for policies serving lesser economic interest, the price of economic rights fulfilment policies might be reduced relative to other policies. Some examples can be increasing prices for indulging in fraudulent activities, corruption, unethical perks etc. This kind of behavior of the voter will result in decrease of favoring of self-interested policies. Thus, in order to fulfill self-interested utilities, a policy-maker will have to address the economic-rights fulfilling policies so as to secure a second term.

Therefore, if the voters are aware about their economic rights and put them on a high pedestal, the policy-makers will be necessitated to direct their funds in such a manner as to secure more economic rights to the people.[120]

[119] MINKLER *supra* note 95.
[120] *Id.*

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Further the basic rights can be classified into two types: security rights and subsistence rights.[121] While the security rights may denote the role of State to be that of protection from criminal activities such as rape, assault etc., it is the subsistence rights that cover major economic rights. Since all these rights are 'basic' rights, there is no question as to preference of one over the other.

5.2. BARRIERS & ERRORS IN IMPLEMENTATION OF POLICIES

An important error that often occurs with respect to policy implementation of these rights is dependent upon the fact that substantial uncertainty exists between policy implementation and its outcomes. Therefore, it is essential that instead of subject conjectures, policymakers rely more on objective probabilities of the outcome.

In predicting the outcomes of these policies, it often occurs that certain policies are overvalued or undervalued as we take into account various considerations. Amartya Sen has written extensively to dispel the notion that higher income is intrinsically good.[122] Rather, according to him, it results in fulfilment of good, long, happier life and more social inclusion.[123]Due to this error, at times, the policy maker fails to take into consideration policies that would produce same outcomes more directly.

Another barrier to implementation is that there are some policies which may involve high costs initially and the results may be visible only after a point of time when policymakers may no longer hold the office in order to claim the credit. This discourages them in making long-term policies and the decisions are often given into popular public opinion.

5.3. TRANSCENDING PRIVATE-PUBLIC DICHOTOMY – REQUIREMENT OF A PERFECT BALANCE

[121] ALVA *supra* note 117.
[122] MINKL:ER s*upra* Note 95.
[123] *Id.*

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As a policy-maker being involved politically and aware of the possible errors being committed due to various reasons, it is essential that the laws are designed in such a manner, so as to transcend the public-private dichotomy. That is to say, ignorance of what happens in the private sphere makes exploitation of economic rights by private bodies irrelevant.

It is essential that the policy-makers through its various organs realize that often what happens in the public domain is a result of interaction with the private entities through formal or informal relationships.[124] A State-centered approach will fail to address these issues and capture reality. As a result, meaningful access to essential economic rights will be denied.

The power is generally yielded from the private parties in terms of providing goods and services. Making economic rights enforceable only against the State will result in turning a blind-eye from the source which has yielded the power in the first place.

In such a scenario, the application of rights horizontally becomes all the more essential.[125] Such a horizontal approach will result in a balance in addressing the economic rights violation both in public and private sphere. This will result in expansion of the legal capacity of an individual, more accountability, better judgement of the policies in force, judicial sensitivity towards rights and thus, effective enforcement of the economic rights.

VI. CONCLUSION

Economic rights do not comprise merely of some negative rights. It comprises of rights that '*make life worth living*'. They range from right to food and security to right to employment. The current literature on economic rights and unsettled debate raise several questions with respect to upholding these economic rights in their true sense and spirit to

[124] Mary E. Becker, *Politics, Differences and Economic Rights*, 8U. CHI. LEGAL F. 169 (1989).
[125] Marius Pieterse, *Relational Socio-Economic Rights*, 25 S. AFR. J. ON HUM. RTS. 198 (2009).

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each and every individual, irrespective of financial or social position. The pertinent question that rises is, what is the best means to address them.

The author suggests a three-pronged approach by involving the process of constitutionalizing, adjudicating and policy-making. This study highlights the lack of recognition of economic rights as 'rights' but as directives merely. The direct impact of this is visible on Human Development Index (HDI) and Physical Quality of Life Index (PQLI). The Indian Judiciary has come a long way in establishing a direct correlation between these 'second generation rights' and the very essence of the Constitution, i.e. Right to human dignity. In the absence of justiciable rights, judiciary needs a modification in the adjudication process by conferring greater role to bodies not only like NHRC but also to other Non-Government Organizations to ensure that the orders are implemented. The third prong of this approach is that of policy-making.

The author has highlighted the errors that are committed by the policy-makers due to various political or personal interests which directly impact the Utility (U). A relation has been expressed between the government effort and its utility. Thus, if the voters are well aware about the implementation of their economic rights, making policies beneficial economically will secure another economic term to the policy-maker more easily.

Finally, in order to address all these issues, a state-centric approach may not serve the purpose. It is essential that the activities in the private sphere are also made a part of these economic right protection measures. A relational socio-economic approach is required by the policy-makers as well as the judiciary to ensure that law acts as a social engineer to fulfill the needs of a modern man.

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CORPORATE LAW & ECONOMICS OF LIMITED LIABILITY: A PERSPECTIVE OVERVIEW AND SOME OPEN QUESTIONS!

- *Lucas Fulanete Gonçalves Bento*[*]

I. INTRODUCTION

Limited liability is considered to be "the feature" of corporate law. From a Corporate Law & Economics perspective, for very broad and different economic stimuli and reasons, it is supposed that limited liability provides gains from improving liquidity and diversification.

Although, it is knowledge that in some cases where there is much less separation between management and risk bearing, those gains are minimal while creating a high probability that a firm will engage in a socially excessive level of risk taking. When such cases happen and are studied in closed corporations, they are obviated by the piercing the corporate veil.

Here, we are proposing an overview of the economic and legal reasons of the creation of limited liability rule. We will review in a structured and organized manner as to how such topic has been studied by the mainstream scholars of the area, adding some personal analysis to the topic under combination of more recent studies of behavior law & economics and social development economics.

Also, in this essay, we bring as first publication of our current topic of research at the University of Hamburg, in which we propose that the even in publicly listed corporations, when the major active controlling shareholder figure is known and indentified, the lack of well defined separation of management and risk bearing has very close effects to the closed corporation cases; excepting that piercing the corporate veil in such situations may have potentially even more harmful effects.

[*]Lawyer, LL.B. at the University of São Paulo with sandwich period as Visiting Scholar in Law & Economics at the University of Illinois at Urbana-Champaign UIUC and IV SILE of Economic Analysis of Corporate Law and Commercial Contracts in the Coase-Sandor Institute for Law & Economics at The University of Chicago. PhD Candidate in Corporate Law, Commercial Contracts and Capital Market at the Universität Hamburg.

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II. LAW & ECONOMICS OF LIMITED LIABILITY

Bainbridge and Henderson (2016, p.1) says that the production in other forms of organizations that not such in limited liability corporations is known for thousands of years, however, the result of using such forms were widespread poverty as well as low levels of productivity and innovation.[126] For them, the central problem was that risk taking and collaboration were inhibited using other forms of organizing activities, as all the investors of such previous forms of business endeavors were carrying unlimited risky for each of its investment.

In that sense, focusing in the importance of legal tools designed for social development, Cooter and Schäffer (2011) has explained that the growth of the economy happens when companies develop innovations and those innovations depend on the combination of new ideas and capital.[127] Although, to combine these two it is necessary to face the mutual trust dilemma; meaning that to develop one innovation, idealizer shall trust that the investor do not steal its new idea and the investor shall trust that the idealizer to not divert the capital invested.

Frank Easterbrook and Daniel Fischel (1991, p. 41/44), summarizing the studies in the economics stimuli brought by limited liability as a corporate law rule, come onto five aspects of it:[128]

- **i.** Limited liability makes diversification and passivity a more rational strategy and so potentially reduces the costs of operating the corporation.
- **ii.** Limited liability decreases the costs of monitoring the agents behavior in managing the company.

[126] STEPHEN M. BAINBRIDGE & M. TODD HENDERSON, LIMITED LIABILITY: A LEGAL AND ECONOMIC ANALYSIS 1 (Edward Elga 2016).
[127] HAND-BERND SCHÄFER& ROBERT D COOTER, SOLOMON'S KNOT: HOW LAW CAN END THE POVERTY OF NATIONS (Princeton University Press 2011).
[128] FRANK H. EASTERBROOK & DANIEL R FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW41-44 (Harvard University Press, Cambridge, Mass 1991).

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iii. Limited liability makes identity of others shareholders irrelevant in the valuation of the company's and insolvency risk of it. Thus limited liability avoids the costs of monitoring all the shareholders.

iv. Limited liability permits easier transfer of blocks of shares, which facilitates a new shareholder who buys a block of shares and acquire the power to change the managers of the company. This potential for displacement gives the existing managers incentives to operate efficiently in order to keep share prices high.

v. Limited liability permits that shares are fungible. With limited liability the value of a share is a function of the income stream generated by the firm's assets, what permits that every share has a price to be negotiated, otherwise, the value of share would be a function of the present value of the future cash flow and the wealth of the shareholders, becoming not fungible.

In the next section of this essay, we will explore these five aspects as considered by the use of simple examples and bringing some extra thoughts on its effects in the mutual trust dilemma.

2.1. MODELING THE ASPECTS OF LIMITED LIABILITY

Imagine a person holding $ 100.000 patrimony and he wishes to invest the available half of it in a company. From this, let's compare two situations; with and without corporate shareholder's limited liability. In the first the limit of his losses is $ 50.000, since if the company fails the worst scenario is that he never gets dividends and also loses the amount invested. In the second there is no limit, since if the company fails the creditors will pursue their credits against the shareholders and it can lose its whole $100.000 patrimony.

It is not hard to figure that the first situation is better off to the investor than the second, once the risk of personal liability for the investor lowers the cost of his investment. To understand even better why the first option is more attractive and fundamental to allow

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the investments in companies' equity, we will describe 5 economic stimuli associated to corporate shareholder's limited liability: 2.1 investment diversification, 2.2 risk aversion compensation, 2.3 reduction of monitoring costs, 2.4 fungible shares, and 2.5 efficient control transfers.

2.1.1. Investment Diversification

Let's imagine again a person holding $ 100.000 patrimony and he wishes to invest the available half of it. But now it has other two options: invest $ 10.000 in 5 different companies or invest $ 50.000 in only one company.

In the first situation his investment is very diversified, so, just to facilitate the calculations, assuming each company has a chance of 50% total failure, he multiplies this chance by the number of investments (50% * 5 = 25%) obtaining a very strong reduction of the total chances of losses, and, indirectly, his cost of investment (25% * $50.000 = $12.500). If one compares this situation with that of only one investment, then all the $50.000 is exposed to only one time of the 50% fail rate (50% * $50.000 = $25.000), what using our number for example given, makes this situation an investment twice more risk costly.

However, everything we have described above is only being worse of because of in a no corporate shareholder's limited liability investment. In the first situation, the person would not rely in the diversification as a strategy of investment cost reduction, because he knows that each of those 5 investments can consume the whole $100.000 patrimony (which includes the amounts allocated in other investments) in case of a total fail.

The non stimulus for the diversification has a potential strong effect in economy as well.

By that what concerns here is that new ideas usually are initially funded by more relational investors (famously famous in finance as 3 Fs, family, friends and fools) or professional high risk-taking investors (private equity and venture capital - whom are

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also very relational addressed), and in either situations a relational investor has interest of funding the idea it is not willing to expose its whole patrimony by doing it; same to a professional high risk-taking investor that really works with business where the rate of total fails is way higher. This business only exists because the investor will have losses limited to the amount invested in each company, and the one company that goes well will compensate the ones that went fail.

So, as elaborated above, without the corporate shareholder's limited liability, the dilemma of mutual trust would set its point for the investors, that would not feel comfortable in funding new ideas instead of allocating their capital in more trustworthy investments (such as consolidated business or financial system). This situation not only hampers the development of economy's growth but also makes the concentration of capital and income (inequality) even more probable.

2.1.2. Risk Aversion Compensation

Kahneman &Tversky (1979) have proved that besides, from the mathematical finance perspective for investments, damage losses and profit losses are equivalent, the psychological effect of them in the investors are not the same.[129]The behavioral consequence of this difference is that risk-averse investors will not invest in situations where there is a posited expects monetary value just for the fear of suffering a damage loss.

Taking once again the example of our investor holding $100.000 patrimony willing to invest the available half of it; let's imagine that he has two investment proposals with and expected positive value in both; to invest in company or to buy some kind of debt bonds. In the first investment, if the business plan of the company works, by the end of the first year, the investor gets an increase in his equity participation of 50%, however, there is also a 50% chance that the company fails and he loses everything invested and also he

[129] Daniel Kahneman& Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 263 (1979).

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has to cover extra $1.000 in discovered liabilities of the company. In the second investment, he will be paid a 15% of interest rate and the risk of default is 5%.

For the investment in the company the expected monetary value (MVc) can be expressed as MVc = (0.5)*($50.000+$25.000) + (0.5)*(-$50.000-$1.000) = $63.000. And, for the investment I bonds the expected monetary value (MVb) would be EVb = (0,95)*($50.000 + $7.500) + (0,05)*(-$50.000) = $57.125.

In this situation the expected monetary value of the investment in the company is ($63.000-$57.125=$5.875) is more than 10% higher than the expected monetary value of the investment in bonds, however, the idea of extra damage loss (the $1.000 extra that the investor can be called to cover) makes him avoid this kind of investment.

Once again we have the shareholder's corporate limited liability working as a tool to deal with the mutual trust dilemma and facilitate that more investors, even with higher levels of risk-aversion, makes the decision of funding companies and business ideas instead of going for less social desirable investments; as explained above companies and new business ideas are the most important ground for economy growth and development.

2.1.3. Reduction of Monitoring Costs

Now we come to the point that shareholder's corporate limited liability deals with the mutual trust dilemma in its most evident way. The point here is that, because of shareholder's corporate limited liability, the identity of the other shareholders of a company are almost irrelevant. In a company with no corporate shareholder's limited liability, the wealth of each shareholder to cover the potential discovered liabilities of the company, in case it fails, matters for the valuation of the company itself and for the valuation of each shareholders share in the company.

When an investor is going to make an investment in a company with no corporate shareholder's limited liability it would have to verify the wealth of each of the other

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shareholders, in order to attest they are wealthy enough to cover their part of the discovered liabilities if the company fails, otherwise, it will pay more discovered liabilities that the others shareholders couldn't cover. Also, besides the preliminary verification, the investor would have to monitor it, meanwhile, he keeps his investment because the wealth of the other shareholders can (and most probably will) change and it will change the risk and value of its own investment.

The costs to make this kind of verification and monitoring would be very high and inefficient, especially when it comes to large companies with thousands of shareholders. Also, it would bring up two very well known costly market failures: information asymmetry and quality uncertainty.

First, it is not necessary much more arguments to assume that the information that each of the shareholders would have about the other would not be homogeneous. This asymmetry would creates all kind of the different valuations for the company. Each shareholder would have its own valuation of the company, once they have different information of the financial asset of the other shareholders.

For the second, we would have a quite close situation of quality uncertainty as showed by Georg Akerloff in "Martket for Lemons". The patrimony and wealth of each shareholder would always be uncertain for the others, even because of the changes it can suffer constantly. This uncertainty, caused by a sort of obstacles (and costs of information) to have a trustworthy quality of the other shareholders, would make each of them take it as a factor to undervalue the other's wealth.

Both cases lead us to a conclusion that without the corporate shareholder's limited liability, the monitoring costs of making an investment in a company would be way higher and would end in a general tendency of less investment of this kind.

As said before, this point is most evident when it comes to see from the mutual trust dilemma perspective, because once there is no stimulus for the shareholder to trust in the

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quality of the information it get about the valuation of the company it is considering to invest in; corporate shareholder's limited liability makes the information about of other shareholders almost irrelevant as considerable risk of the investment, and, as consequence, for the valuation the company.

2.1.4. Fungible Shares

One way of companies to look for funding on their business ideas is the development of Capital Market. Public offering shares of the company for any interested investors, the company can fund their ideas without taking current liabilities, and on the other hand the investors can allocated their available money in investments that are supposed to bring higher expected monetary values and have also liquidity enough in case the money is needed by them.

However, the possibility of a Capital Market is based on the idea that it does not matter who the people are holding the shares of the company, just if they have paid their subscription money.

III. WHY PIERCING THE CORPORATE VEIL?

As shown, the body corporate not only protects firm assets from shareholder's debts, but also protects shareholders from liabilities arising from the corporate activities. For both sides limited liability has been the tool to provide the proper development of companies and business activities in the way it is known nowadays and for such it is not a rule that can be set aside easily given its individual and collective importance.

However, in certain situations, courts are likely to allow creditors to absorb the assets of the shareholders. Those decisions are based in cases where limited liability provides minimal gains from improve liquidity and diversification, while creating a high probability that a firm will engage in a socially excessive level of risk taking.[130]

[130] EASTERBROOK & FISCHEL, *supra* note 128, at 55.

The principle of the correspondence between management of business power and risk taking liability plays a relevant role in economic life. It sanctions the irresponsibility in the conduct of the company. Faced with the possibility of suffering the consequences for irresponsible managing, the holder of business power naturally tends to exercise his activity with diligence and care.[131]

Most of the cases on disregarding the corporation's legal entity, allowing the creditors to reach shareholders assets, happen in closed corporations.[132]

Some explanations for that theory is that there is much less separation between management and risk bearing, because those who supply capital in a closed corporation typically are also involved in decision making.[133] In those cases limited liability does not reduce monitoring costs, at the same time the diversification are much less important in closed corporations.

3.1. CORPORATE CONTROL

For majority of the scholars veil piercing should be rare, as per as they are intend to understand that such doctrine are still unprincipled and arbitrary.[134]

However, a comparative study on the empirical studies of veil piercing in a variety of countries, even between different legal systems, has shown a very common sense between all of such decisions, they identify an "owner" of the corporation that dispose of its assets as off him/her/itself.[135]

[131] EDUARDO SECCHI MUNHOZ, DESCONSIDERAÇÃO DA PERSONALIDADEJURÍDICA 213 (2002).
[132] ROBERT B. THOMPSON, PIERCING THE CORPORATE VEIL: AN EMPIRICAL STUDY 1039 (1991); EASTERBROOK & FISCHEL, *supra* note 128, at 55; CHARLES MITCHELL, LIFTING THE CORPORATE VEIL IN THE ENGLISH COURTS: AN EMPIRICAL STUDY 17 (1999).
[133] CLARK, ROBERT C. CORPORATE LAW. BOSTON: LITTLE BROWN & COMPANY, 1986.
[134] BAINBRIDGE & HENDERSON, *supra* note 126, at 19.
[135] THOMPSON, *supra* note 132, at 1039;EASTERBROOK & FISCHEL, *supra* note 128,at 55; MITCHELL, *supra* note 132, at 17.

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The dynamics of power in corporations was the object of several legal attempts to understand reality by categories suitable to frame business power, but the mutability of these relations of power has always exceeded the scope of such understandings.[136] When we talk about the control over a corporation, some different understandings through comparative law can be found.

In the German stock law of 1965 which defines control from a broad notion of dominant influence (§ 17 et seq.), as well as the Italian civil code, amended by Law no. 216 of 1974, which defines controlled companies as companies that are under the dominant influence of another company because of the shares or quotas held by it, or of particular contractual links with it (article 2.359).

Even in South America, we have the Argentine law of 1972 that defines as controlled companies those in which another company directly or through another company, in turn controlled, has participation, for any title, which grants the necessary votes to form the social will (article 33).

The Brazilian Corporate Law, dealing with the figure of the Controlling Shareholder, defines it as the natural person or legal entity, or group of persons bound by a voting agreement, or under common control that, having the rights of a member that the majority of votes in the deliberations of the general meeting and the power to elect a majority of the company's directors, and effectively uses that power to direct social activities and guide the functioning of the company's organs (article 116).

In order to explain the legal qualification of the power of control, it is helpful to understand some concepts from the German doctrine on the gender of the powers of action on others legal sphere.

From that we can see that the power of control is not a formant right (*Gestaltungsrechte* - which is exercised in the benefit of its own, eg the right to vote), or a management or

[136] PATELLA, Laura Amaral, Controle Conjuntonas Companhias Brasileiras: disciplinanormativa e

administrative right (*Verwaltungsrechte* - exercised in the benefit of the subjects whose legal sphere produces effect, by means of a derived prerogative, eg trustee). It is a power properly (*Macht-befugnisse*), which involves exercise in the benefit of the subject on whose legal sphere produces effect, however, by exercising its own prerogative.[137]

For that reason, the behavior of those who holds and use power of control closely approximates that of an individual entrepreneur. The concentration of capital permits that the controlling shareholder uses the benefits of the corporation form, without losing its prerogatives to control the business itself.

The controller essentially has the power to dispose of these goods, to sell them, to mortgage them or to engage them, to exchange them, or to consume them. Such power, well known to lawyers, is the classic *iusabutendi*, an essential element of property. Control is therefore the right to dispose of the property of others as an owner. Controlling a business means being able to dispose of the goods that are destined for it, of such art that the controller becomes master of its economic activity.

3.2. NOT A CONCLUSION

After reading the above it may seem that we are arguing at the corporate control shall be the key factor of the veil piercing or either the fundamental reason for it, but as the subtitle of this section shows, that is not a conclusion we are seeking or even agree.

In seminal text Berle & Means (1993) has understood the corporate control in multiple categories depending on the factual reasons of such control.[138] As showed by them it is possible to control a company since from the obvious aspect of majority shares to the aspect of excessive diversification in shareholder's ownership structure, permitting that any minimal amount of concentrated capital controls the company.

pressupostosteóricos, 11, (2015)(Unpublished PhD thesis Faculty of Law, University of Sao Paulo, São Paulo).

[137] FÁBIO KONDER COMPARATO & CALIXTO SALOMÃO FILHO, O PODER DE CONTROLE NA SOCIEDADE ANÔNIMA139 (4th ed. 2005).

However, for the sense of proprietorship behavior for the power of control, as we have shown above, does not seem to be applicable to every category, especially if we are talking on categories that do rely on the passivity of other stakeholders.

In that sense, it is important first of all to be sure that we are talking as fundamental factual "box check" in veil piercing, the possibility of indentifying a major controlling shareholder, whom its majority is in such level that factually nullifies the opposition of minority shareholders by ordinary means.

Even though, it is not our intention to advocate that the control in such a sense should be the reason of piercing the corporate veil. We understand it just as a factual circumstance which has been verified in the decisions of those cases. In economic terms, we can say that control is correlated to the possibility of piercing of the corporate veil, but not the cause of it, especially it cannot be in the case of publicly listed companies, as exposed.

IV. WHAT REMAINS FROM THE ABOVE?

As said from the introduction, this essay aims to a brief review on the economic and legal reasons for the limited liability rules and its abuse and remedies. We also pointed out that piercing of the corporate veil, it's the known remedy but mostly it is somehow feared by majority of the scholars, even though we do believe, under the analysis of empirical studies, that there is a common ground, even just from a factual perspective, to sustain such a doctrine.

From that, and as brief as the text is proposed to be what really remains is the non answered question by empirical studies. By that we mean, we showed that piercing the veil has been used as the remedy for abuse of corporate limited liability, however such solution as almost exclusively applicable to closed corporations with low number of shareholders.

[138] ADOLF A. BERLE & GARDINER C MEANS, THE MODERN CORPORATION & PRIVATE PROPERTY (Legal Classics

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In concentrated markets, although, the existence of an effective controlling major shareholder is not uncommon even in publicly listed corporations.

As showed by La Porta *et all* (1998), in 1996, besides USA and UK, all the countries with established stock exchange organizations for equity capital market has more than 50% of 20 largest publicly listed companies with strong block holders. As well as, if we talk about Brazil, in 2014, from the largest 225 publicly listed companies 90% has a defined controlling shareholder that holds in average 76% of voting capital and/or 54% total capital.

The existence of a figure such as controlling shareholder seems to not be very suitable for the economic reasons that supports the benefits of limited liability, however, it does not also seems to be possible to establish a equity exchange market without this feature.

In such context, comes the research questions to be answered here proposed: does such control in publicly listed corporations affect the benefits of the limited liability as a corporate feature that allows investment? If so, is the veil piercing the proper solution for freshen the necessary economic backgrounds needed for corporation investments development?

As our preliminary view, we understand that in concentrated markets the confusion between corporate control and business control is so intensive that the limited liability is not a sufficient feature to guarantee the economic stimuli that it provides for the development of equity capital markets in non-concentrated corporate ownership environment.

However, the solution of disregarding the limited liability, as provided by the courts especially in closed corporations, has no better economic consequences. So that, we aim that if confirmed our proposition, it is our current topic of research, and for which we

Library New York N.Y. (1993).

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once again open the invitation for inputs of all readers, how to construct different legal features for business controlling liability to provide economics stimuli, that aligned with the limited liability, could avoid the confusion between majority shareholder and business control on corporations or at least the non-contributively effects it can have in the development of an equity capital market.

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STANDARDIZED DATA COLLECTION: LEGAL REQUIREMENTS, GUIDELINES, OR COMPETITION?

- *Frank Fagan**

I. INTRODUCTION

Imagine that a U.S. bank wishes to develop a predictive model for granting credit to borrowers below the poverty line. With the current U.S. population at 325 million—of which nearly 40 million live in poverty[140]—the universe of available data for making predictions may be limited. Even if a quarter seek loans, and the bank has experience lending to 10% (or 4 million borrowers), the amount of predictive precision required for avoiding bad loans and creating a profitable lending business may be insufficient nonetheless since data about past loans may be inadequate.[141] In other national markets, where the population is larger—in particular the number of those living in poverty—data may be available for developing a sufficiently precise predictive model.[142] That model would obviously be profitable in its country of origin, but for export, the predictive patterns that it identifies at home must also be present abroad. In terms of industrial strategy, developers of predictive models for export could collect and test general stocks

* Associate Professor of Law, EDHEC Business School, France. I thank Dean Ranita Nagar for her invitation to submit this Essay to the *GNLU Journal of Law & Economics*, and for comments, Saul Levmore.

[140] *Basic Statistics*, TALK POVERTY, http://www.talkpoverty.org/basics (last visited Feb. 24, 2019).

[141] Note that, with current technology, "supervised deep learning algorithm will generally achieve acceptable performance with around 5,000 labeled examples per category and will match or exceed human performance when trained with a dataset containing at least 10 million labeled examples." IAN GOODFELLOW ET AL., DEEP LEARNING 2 (2016). Thus, the bank may have insufficient data even if it can purchase other data from data brokers, especially in contexts where counterfactuals matter, but remain generally unobservable. In this example, the bank may be restricted by profit margins from observing the outcome of granting loans to those whom the model borderline rejects. It might "invest" in developing a more precise predictive model by randomly granting loans to the rejected, losing some money in the process, and then teaching the model from those random loan observations to enhance decision making accuracy in the future. But this method will reduce current lending margins and may not be profitable in a present value sense in some markets, inhibiting a project from taking place. See Frank Fagan & Saul Levmore, *The Impact of Artificial Intelligence on Rules, Standards, and Judicial Discretion*, 93 S. CAL. L. REV. *9-10 (forthcoming 2019), which discusses the same problem within the context of unobserved flight of arrestees who are denied bail. Instead of negative net present value, the problem with randomly granting bail in the arrestee example is potential equal protection violations and arbitrariness through random application of rules. On equal protection violations, see Michael Abramowicz, Ian Ayres & Yair Listokin, *Randomizing Law*, 159 U. PENN. L. REV. 929, 964-74 (2011). For a discussion of problems with arbitrariness, see RONALD DWORKIN, LAW'S EMPIRE 178-84 (1986).

[142] Of course one million observations may be sufficient for developing a useful and profitable predictive model. *See* GOODFELLOW ET AL., *id.* at 141. The example merely demonstrates the intuition of the problem. So long as generalizable data is collected and mined at a lower cost in the exporting country, there exists an opportunity for predictive model exporting.

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of data alongside country-specific ones. In terms of policy, law could nurture low-cost data collection that stimulates the construction of models at home.

But law could go a step further and additionally encourage the development of broadly useful predictive models, especially in national machine-learning-based infrastructure investments. This can be done with substantive data collection requirements in exchange for government funding or tax incentives, or the development and announcement of process-based standards for data collection.[143] Imposing substantive data collection requirements in exchange for funding is efficient inasmuch as the project is beneficial and the additional requirements can be profitably used in other contexts. The imposition of process-based standards entails social cost, but the provision of guidelines may be enough to reap the rewards of standardization when the private benefits from data independence are small. Efficient standards may fail to emerge, however, even with law's endorsement, in the presence of severe collective action problems.[144] Of course, the danger of endorsement is that the standard itself is inefficient. Competition among jurisdictions—in particular, a national desire to win the global AI race—may be expected to bring about efficient results, but only if big data is big enough within jurisdictions or across the jurisdictions of federated partners.

All of this is consistent with the problem (and general mystery) of choosing between the benefits of competition and economies of scale. Technical data collection standards present the added complexity that lawmakers may be unable to distinguish between efficient and inefficient leapfrogging. In other words, do the presumed economies enabled by standards today outweigh the drag on the potentially beneficial standards of tomorrow? And will mandating standards today eliminate the possibility that future and superior standards will arise? The answers to these questions are perhaps, at this point, still irregular enough to be empirical, and in any case, are left for future work. Today, on

[143] Standardized data collection furthers data portability and interoperability, which are often pre-conditions for cross-firm and cross-industry data exchange. *See* Pol'y Dep't A: Econ. & Sci. Pol'y, Eur. Parl., *Industry 4.0* (Feb. 2016), http://www.europarl.europa.eu/RegData/etudes/STUD/2016/570007/IPOL_STU(2016)570007_EN.pdf; *see also* FED. TRADE COMM'N, DATA BROKERS: A CALL FOR TRANSPARENCY AND ACCOUNTABILITY 2 (2014) (on consumer data collection practices).

[144] *See infra* § III.A.

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the other hand, surely the benefits of standardization must be discounted by an uncertain future. Standards may generate economies of scale, but they simultaneously inhibit competition and its benefits. This is the danger of centralized standards either imposed or announced. Good arguments for economies of scale can easily be made but difficult to believe upon further scrutiny. In other settings, auctions can serve as scrutinizers, though perhaps here, instead of firms bidding for a right to be sole data collector or something similar, piecemeal subsidies for collecting general variables can generate yet more data that works well over time and space, and something short of qualified standards can continue to be left in the hands of innovators.

Section II begins by describing the technical limitations of standardization benefits drawing on examples from natural language processing and agricultural science. Section III turns to legal strategies for encouraging coordinated data collection in the presence of social limitations, and in particular, the role that law and public policy plays in driving down costs among competing groups. Section IV concludes.

II. THE LIMITS OF STANDARDIZATION

It is widely understood that the impressive progress and advances in AI over the past few years have been primarily driven by an exponential increase in computing power, vast production and collection of data, and important breakthroughs in algorithm design.[145] What is less understood is that machine-learning, an important subset of AI,[146] is dependent upon two conditions: (1) that patterns or regularities are observable, and (2) that the environment in which those patterns occur is sufficiently stable.[147] Machine learning loses its advantage when patterns are unseen or the future is uncertain. These conditions, especially the second one, tend to focus on time. Equally important is space.

[145] Anant Maheshwari, et al., *Age of Intelligence*, Microsoft India White Paper, February 2019.

[146] Artificial intelligence is used here as a general term as the ability of machines to improve on their own, after humans set the machine's goals and provide it with some data. Machine learning is used as a subset of AI in which machines look for connections, reach conclusions, or look for more data in ways beyond what its human programmers contemplated. These definitions are not exhaustive, and may not even stand the test of time, but are used here to describe the workflows for constructing predictive models and how those workflows can be streamlined with data collection standards. For a discussion of the optimal division of labor between humans and AI when building predictive models, see Fagan & Levmore, *supra* note 141, §II.

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An observable pattern or regularity present in one part of the world may not exist in another. While these two conditions capture this fact, they tend to obscure the importance of environmental consistency across space in order for machine learning to be broadly useful. It is obvious that a predictive model may work in India, but not the United States; the United States can introduce additional and relevant variables that do not exist in India. At the same time, the Indian predictive model may capture variables not present or relevant in the United States, which though critical for accurate prediction in India, offer little predictive power elsewhere. If either the Learnable Regularity Assumption (1) or the Invariance Assumption (2) is violated, then the benefits of standardization become limited. Even wider data sharing across environments is not useful unless it illuminates some aspect of either environment that is stable and measurable.

2.1. DISSIMILAR VARIABLES ACROSS MARKETS

Consider a Natural Language Processing tool developed in India to automate customer service in each of India's twenty-three official languages. For each language, a predictive model might compute several variables, including what the customer says or which questions the customer asks, in order to predict the appropriate output response of the automated call agent. Data collection would surely include customer utterances in the spoken (local) language, and the accuracy of the response given by the predictive model would at least partly depend upon those local utterances. If the model is dependent on language, then its usage is confined to the language of its construction and its market is likely confined to geographic regions where that language achieves critical mass. The model might be extended to account for language-independent features of speech, which could generate predictive capabilities for export, but investment in a language-independent model in this context seems unlikely. One only needs to assume that the economic costs of developing a sufficiently accurate language-independent model in India exceed the costs of developing either type of successful model in the importing locale. This assumption seems reasonable. Language data itself is easy to collect, and its

[147] LESLIE VALIANT, PROBABLY APPROXIMATELY CORRECT 61-62 (2013).

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use in developing predictive customer service applications is more straightforward than language-independent features like the time of day when the call takes place, the type of product for which service is required, or the age of the caller.

This does not imply that models which ignore local languages may have important commercial uses that can be profitably exported by frugal innovators. For instance, models that predict caller mood across twenty-three languages based upon a collection of language-independent variables may have important commercial applications in say, the European Union, which itself has twenty-four official languages. The point is that in some cases, language-dependent models for specific customer interactions may get the job done more accurately and at a lower cost, even when developed in a relatively higher cost location. If homegrown models are comparatively efficient, then there is less space for predictive model exporting and fewer benefits accruing from standardization across jurisdictions.

2.2. DISSIMILAR ENVIRONMENTS ACROSS MARKETS

As a second example, consider a model that predicts rice crop yields. This model can be based upon a variety of inputs such as how many seeds and of what type are used in a given amount of space; how much water is absorbed by them; various climatic features such as sunlight, humidity, barometric pressure, and temperature; and so on. It may include features of the soil, such as its density, mineral content, the presence of particular insects and organisms, and the number and type of previous crops grown. A predictive model that incorporates exhaustive features of rice crop yields may include attributes of the farmer such as age, height, and weight, in addition. Many types and combinations of variables can be imagined.

It may appear, on the surface, that if this model were developed in Assam, it may have little value for farmers in Idaho. Assam's growing conditions are different from Idaho's, so what is the need to make comparisons? A robust causal model might direct a farmer to apply lesser water at night than in the morning, no matter what the location is, but even a

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powerful predictive model may offer little guidance if it has never observed Idahoan features. Only if those features are sufficiently similar to those of Assam, will the model prove useful in Idaho. Equally important is that the *unobserved* features of Assam must be sufficiently similar to their counterparts in Idaho so as to not distort the prediction. If critical features—observed or unobserved—are different, then the Assam model will contain no observations relevant to Idaho to support a prediction there.[148]

Say the model ignores wind velocity, and that Assam experiences higher wind velocities than Idaho. Wind speed is important for rice crops. It increases turbulence in the atmosphere, and as a result, increases the supply of carbon dioxide to plants, thereby accelerating photosynthesis rates. This unmeasured difference between Assam and Idaho, if substantially different, will distort the predictive outcome. But say that all Idahoan rice crops are planted on Idaho's plains. The plains are flat and open and subject to higher wind velocities. Because the model does not measure wind speed, it is only predictively useful to Idahoan rice farmers situated on the plains. The relevant market for the predictive model might be expanded to greater parts of Idaho only if wind speed were measured in Assam. While the measurement of wind speed may increase the cost of developing a predictive model for Assam farmers and offer little economic benefit there, its measurement may be more broadly useful outside of Assam. So long as the additional cost of collecting and testing a model that includes wind speed is worth it, measurement should be undertaken for predictive model exporting. Thus, local features, including geography, can be expected to limit the demand for (and patterns of) standardization of data collection.

III. LAWS ROLE IN DATA COLLECTION

3.1. COORDINATED DATA COLLECTION (PROCESS)

The benefits of coordinated data collection are straightforward. Data portability and

[148] This point is conceptually identical along a time dimension as well. If Assam in 2025 presents sufficiently different patterns or a sufficiently different environment, then a predictive model built in 2019 would be based upon regularities that do not exist anymore.

interoperability reduce the costs of creating predictive models. Coordination reduces (1) duplicative data collection; (2) unnecessary conversion of data formats; (3) translation of communication protocols between routines that collect, organize, and store data; and (4) potentially reduces errors.[149] Law has shown an appetite for standardized information about food, fuel, medicine, appliances, and automobiles—primarily to protect consumers and reduce search costs.[150] Requirements for business-to-business transactions include, among others, the transportation, chemicals, and petroleum products industries.[151] Many of these standards impose requirements on content collection and reporting. In other words, they regulate *what* must be collected and reported. By contrast, process-based standards for coordinating data collection would involve *how* data is collected, organized, and stored. Inasmuch as collection, organization, and storage requires the use of metadata or other variables for portability and interoperability, there will be overlap. Nonetheless, the focus here is on process (and not content) standards. Economists have examined the relationship between standardization and both productivity growth and overall economic growth.[152] In short, standards tend to facilitate competition within standardized markets, which reduce costs and increase product quality, choice, and innovation. On the other hand, standards can lead to long term depression of innovation by reducing choice, increasing market considerations and locking-in an inferior standard.[153]

Thus, while data collection standards may be preconditions for beneficial cross-firm or cross-industry data exchange, their use can lead to social loss. If implemented too soon or too late, opportunities for net increases in growth and innovation may be missed.[154] Even if properly timed, data collection standards may raise barriers for new entrants, stifle

[149] *See* Michal S. Gal & Daniel L. Rubinfeld, *Data Standardization*, 94 NYU L. REV. *12-13 (forthcoming 2019) (discussing the benefits of standardization and noting that standardization can reduce metadata uncertainty).

[150] *See* Saul Levmore & Frank Fagan, *The End of Bargaining in the Digital Age*, 93 CORNELL L. REV. 1469, 1471-72 (2019) (discussing various truth-in-labeling requirements and asserting that law should sometimes require firms to disclose prices to consumers for the same reasons).

[151] *See, e.g.*, NATIONAL INSTITUTE OF WEIGHTS AND MEASURES, *Office of Weights and Measures Programs*, https://www.nist.gov/pml/weights-and-measures/programs (last visited Apr. 2, 2019).

[152] *See, e.g.*, Knut Blind & Andre Jungmittag, *The Impact of Patents and Standards on Macroeconomic Growth: A Panel Approach Covering Four Countries and 12 Sectors*, 29 J. PROD. ANAL. 51, 51 (2008); Joseph Farrell & Garth Saloner, *Standardization, Compatibility, and Innovation*, 16 RAND J. ECON 70, 70 (1985).

[153] Gal & Rubinfeld, *supra* note 149 at *15.

[154] *See generally* FRANK FAGAN, LAW AND THE LIMITS OF GOVERNMENT: TEMPORARY VS. PERMANENT

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competition and innovation, and depress the development of predictive models. From this perspective, the imposition or announcement of standards raises challenging policy questions.

If the future is sufficiently certain and the private costs of compliance with data collection standards are low, then endorsement may be worthwhile. On the other hand, if firms benefit from coordination, then a data collection standard might be expected to emerge in the first place as its optimal timing approaches, and its imposition would be unnecessary. If anything, law might announce a standard to encourage coordination.[155] Standards may fail to emerge, however, if incumbents benefit from fragmentation, or collective action problems prevail—including limited knowledge about aggregated data's potential uses, its expected level of integration, or the propensity of others to follow suit.[156] Additional obstacles have been raised in other work,[157] but the main point is that efficient standards may fail to emerge, even with law's endorsement. Of course, the danger of endorsement is that the standard itself is inefficient. Competition among jurisdictions—in particular, a national desire to win the global AI race—may be expected to bring about efficient results, but only if big data is big enough within jurisdictions. Otherwise, federations should be expected to emerge loosely patterned around traditional collective action behaviour, including the concentration of participants as a reflection of organizational and other transaction costs.

3.2. COORDINATED DATA COLLECTION (SUBSTANCE)

Imagine that a genetic variation, which alters the outcome of medicinal treatment, is widespread throughout a national healthcare market, but less so in another. In the market where this variation is uncommon, the collection, organization, and storage of binary data about its presence during treatment may have little impact on the accuracy of predicting local treatment outcomes. Diagnostic trials required by the local administration agency will likely conclude that the inclusion of this variable in testing is of little value. Firms

LEGISLATION (2013).

[155] *See* Richard A. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649, 1649 (2000).

[156] Gal & Rubinfeld, *supra* note 149 at * 23.

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may wish to include it anyway, even if its presence is scarce, especially if they anticipate that foreign agencies may require its inclusion in future trials.[158] In this case, the firm might choose to include it in order to facilitate expansion into other markets as a result of its profit maximization calculus.

In this case, the predictive model would then be based upon a greater number of observations and (potentially) more robust to other environments. While process-based coordination of data collection increases the number of observations by essentially reducing aggregation costs, substantive coordination increases the number of observations by providing direct benefits to additional data collection effort. Here, the benefits are clear since the firm increases its capacity for trial testing in other markets. But governments can bring about those benefits through tax incentives or conditional infrastructure funding. Suppose a national government invites security firms to bid on a border checkpoint scanning system, for a specific corridor, that draws heavily on machine learning and data collection. Even if the features and aspects of facial expressions don't provide any additional predictive powers for that particular corridor, the national government will impose broad data collection requirements on bidders in order to build stocks of data for use in other locations or other applications.

IV. CONCLUSION

The benefits of standardization are limited by unobservable patterns and variations over time and space. Even if these technical limitations are few, standardization faces social limitations. When the benefits of data independence are high, creators of predictive models will resist imposed coordination. Even if coordination is efficient, concentrated beneficiaries of the status quo will successfully resist the imposition of standards that weaken their positions. And even if the coordination is efficient for all participants, other collective action problems based upon incomplete information may prevent socially beneficial changes. When these obstacles are surmountable, lawmakers should consider

[157] *See id.*

[158] One can assume that the present inclusion can be controlled in local trials and is useful for later testing.

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whether process-based standardization or substantive standardization is efficient. The endorsement of process-based data collection standards entails a social cost, when the standard itself is inefficient, which may be difficult for lawmakers to predict over time. For this reason, an incremental approach realized, for example through substantive data collection requirements of government-funded or tax-incentivized projects, developed and articulated on a project-by-project basis, may minimize errors when the benefits of standards are uncertain. Over time, insofar as benefits become certain and clear, competition among jurisdictions—in particular, the desire of a nation or group of nations to win the global AI race—may be expected to bring about efficient standards, but only if big data is big enough within jurisdictions or across national partners.

It is nonetheless a truism that the benefits of standardization must be discounted, in an expected value sense, by an uncertain future. Standards may or may not generate economies of scale in a given socio-economic environment, but they can be expected to generate centralization and lock-in, while simultaneously inhibiting competition and innovation. This is the danger of centralized standards, either imposed or announced. While economies of scale can lower costs, drive innovation, and enhance welfare generally, all of these benefits depend upon the perfection of the standard over time and space. As a result, standardization arguments can easily be made but difficult to believe after further scrutiny. In other settings, auctions and other price mechanisms serve as scrutinizers, though perhaps here, instead of firms bidding for a right to be sole data collector or something similar, piecemeal subsidies that incentivize the collection of general variables can generate even more data that works well over time and space, and something short of qualified standards, for the form and process of data collection can continue to emerge and remain in the hands of innovators.

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ALLOWING LAWYERS TO CHARGE CONTINGENCY FEES: IMPACT ON THE LEGAL SERVICES MARKET

- *Shubhangi Maheshwari**

I. INTRODUCTION

A contingency fee is a contractual arrangement between a client and an advocate in which the advocate's fee depends on the outcome of the case.[159] The lawyer agrees to make his fee contingent upon the success of his representation and recovery of a sum of money and the fee charged is a percentage of the recovery.[160] While this system is prevalent in countries like the USA, Canada, South Korea etc., India does not allow charging contingent fees. The Bar Council of India strictly prohibits the lawyers from charging contingent fees to their clients.

"Rule 20: An advocate shall not stipulate for a fee contingent on the results of litigation or agree to share the proceeds thereof." [161]

Such agreements are believed to adversely affect advocate's ability to act objectively and in a detached manner as an officer of the court and are considered to hinder the administration of justice. Having a financial interest in the outcome of the case may create perverse incentives for lawyers to resort to unscrupulous practices in order to win the case, which would be detrimental to the interests of justice. It is primarily for such ethical considerations that contingency fees arrangements are not allowed in India.

This essay attempts to study the impact on various stakeholders of the market for legal services, if contingency fees arrangements are allowed in India. The analysis has been done from the perspective of economic efficiency only. The ethical concerns arising from

* Student of Law, National Law School of India University, Bangalore.

159 THE NEW PALGRAVE'S DICTIONARY OF ECONOMICS AND THE LAW, 67 (Peter Newman ed., 1998).

160 Adam Shajnfeld, *A Critical Survey of the Law, Ethics, and Economics of Attorney Contingent Fee Arrangements*, 54 N.Y. L. REV.773, 774 (2009).

161 Rule 20, Chapter II, Part VI, Bar Council of India Rules on Professional Conduct (As amended up to September 30, 2009).

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such systems remain out of the scope of this essay. Section one traces the effect of contingency fees system on the litigants; section two deals with the possible advantages which lawyers can derive from such arrangements; section three studies how the government and the court machinery will benefit from this arrangement and the last section focuses on the problems that can arise out of such agreements.

II. IMPACT ON LITIGANTS

2.1. ACCESS TO COURTS

Contingency fee arrangements have been justified on the grounds of increasing access to litigation. They enable the impecunious to obtain representation in courts.[162] Litigation costs are usually incurred before the final judgement is reached, including costs to bring the case, the delay associated and risks faced. In the current system, lawyers charge for these costs in advance. This implies that those facing difficulty in raising funds are discouraged from pursuing their cases. This defeats the purpose of legal system to compensate the injured party as well as to deter the future injurers.

A recent study conducted by DAKSH concluded that average cost incurred by civil litigant (plaintiff) in India is as high as Rs. 465 per day.[163] Free legal services offered under the National Legal Services Authority Act, 1987 is not availed by many. The study revealed that despite a considerable number of litigants from lower income groups, only 2.36% of all litigants relied on court-appointed lawyers.[164] This can be attributed to poor legal literacy and awareness among the public at large, and to the inefficiency of the government in proper utilisation of funds allocated for legal aid. The current system of legal aid also does not cover members of middle and upper socio-economic classes who may find it difficult to pay hefty legal fees in advance of success of the case. Moreover, the incentives for lawyers to provide free legal aid under the National Legal Services

[162] Shajnfeld, *supra* note 160, at 775.
[163] DAKSH, *The State of the Indian Judiciary: A Report by DAKSH*, (2016), http://dakshindia.org/state-of-the-indian-judiciary/08_contents.html (Last visited on June 4, 2019).
[164] *Id.*

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Authority are insufficient. Contingency fee arrangements on the other hand, will enable such individuals of lower income strata to finance their litigation.

Contingency fees can help overcome the financial limitations by enabling those who cannot afford the cost of litigation to not pay fees unless and until it is successful. These arrangements do not require payment of fees in the event of losing the case and thus, encourage injured parties to litigate.[165] The mechanism can also be helpful for the litigants who are constrained by liquidity and cannot finance litigation on their own.[166] It is thus a cost-spreading solution to the access-to-justice problem plaguing India. The litigant bears the expected cost of winning the case while the lawyer bears the expected cost of losing.[167] This reduces the cost of litigation that the litigants have to bear.

2.2. PRINCIPAL-AGENT PROBLEM

Contingency fees arrangements help solve the *principal-agent problem* which occurs when one party (agent) represents and takes decision on behalf of another and that has an impact on another (principal). There may arise a conflict due to divergence of interests of both the parties. Further, due to information asymmetry with the agent having more information than the principal, the principal is likely to incur *agency cost*. In the market for legal services, this problem arises between lawyers who act as the agents of their clients. The clients are not in a position to monitor lawyers' inputs and ascertain the value of their services. This information symmetry gives way to a possible difference in their interests which leads to a situation where lawyers take decisions that benefit them rather than their client.

The legal profession is considered to be a noble one where the lawyer should prioritise client's interests over his. In other words, ethics must prevail over self-interest of lawyers. However, this is a normative ideal rarely met in practice and the legal services market is

[165] Neil Rickman, *The Economics of Contingency Fees in Personal Injury Litigation*,10(1) OXFORD REV. OF ECON. POL'Y 34, 37 (1994).
[166] Jennifer Arlen, RESEARCH HANDBOOK ON ECONOMICS OF TORTS 390 (2013).

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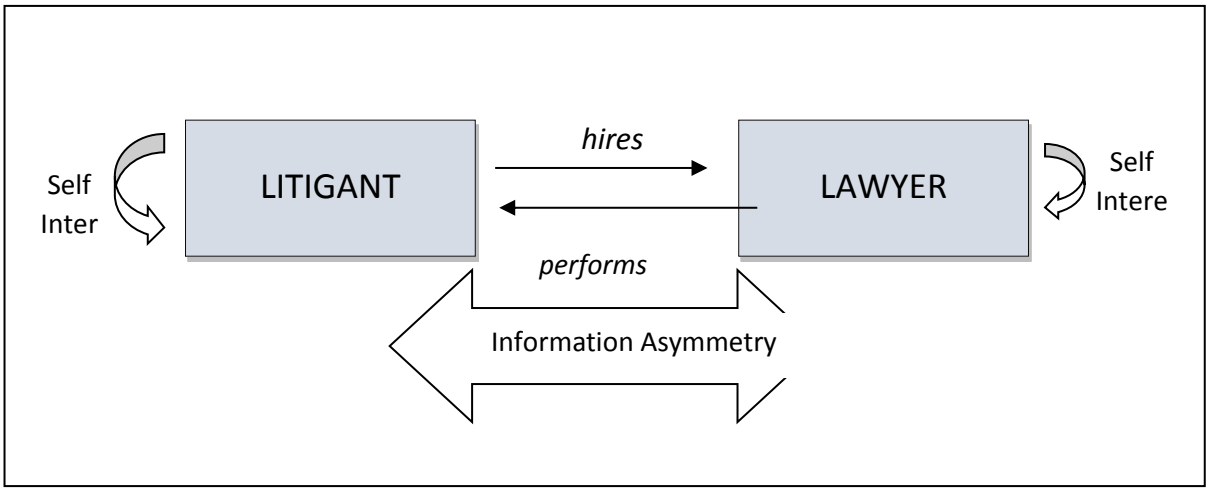
far from the perfect market.[168] The intricacies of the legal system and formalities involved in it facilitate opportunism on the part of lawyers. Hence, it becomes all the more important to align the interest of lawyers and their clients.



2.2.1. Information Asymmetry:

Legal services are essentially credence goods. A credence good is one whose utility is difficult to measure, even after consumption. It arises when an expert knows more about the type of good or service that the consumer needs than the consumer himself.[169] Lawyers are in a better position to provide legal services and ascertain how much to provide. The complexity of the legal system makes it difficult to for the client to determine the strength of his case and value of the services provided by the lawyer, even after the case is over. This gives rise to an information asymmetry between lawyer and his client, creating incentives for opportunistic behaviour on the part of the lawyer.

Further, the client also may have private knowledge about the facts of his case when he brings it to a lawyer and he could hide any adverse information so as to induce the lawyer to take the case. Contingency fees can resolve this information asymmetry by allowing

[167] Charles Rickett and Thomas Telfer, INTERNATIONAL PERSPECTIVES ON CONSUMERS' ACCESS TO JUSTICE 318 (2003).

168 Gillian K. Hadfield, The Price of Law: How the Market for Lawyers Distorts the Justice System 98(4), Michigan Law Review 953, 962 (2000).

the lawyer and client to signal their personal information via the share of contingency fee they offer or accept. In other words, the more risk they are ready to bear, the more favourable their private information must be. Therefore, a good lawyer will charge higher contingency fees, while a well-informed client with a strong case will be willing to pay a lower contingency percentage and vice-versa.[170]

2.2.2. Market Failure

The goal of the litigant is maximisation of the amount recovered as damages or compensation, which depends on the lawyer's efforts and other factors out of his discretion, such as opposite party's efforts, court's discretion etc. Further, the client cannot monitor the efforts of the lawyer.

The table below illustrates this. It shows that the lawyer can work with either low or high amount of effort. Low effort generates either Rs.1,00,000 or Rs. 2,00,000 of compensation (with equal probability) while high effort produces Rs. 2,00,000 or Rs.4,00,000, depending on the random factors. The higher recovery is labelled as 'Good Luck' and the lesser one as 'Bad Luck'. These numbers highlight the problem of asymmetrical information: when the recovery is Rs. 2,00,000, the client cannot ascertain the effort level of the lawyer. This leads to a situation of market-failure in the legal services market.

Amount Recovered after the Success of Trial		
	Bad Luck	*Good Luck*
Low Effort	Rs. 1,00,000	Rs. 2,00,000
High Effort	Rs. 2,00,000	Rs. 4,00,000

[169] Uwe Dulleck and Rudolf Kerschbamer, *On Doctors, Mechanics, and Computer Specialists: The Economics of Credence* Goods, 44 J. OF ECON. LITERATURE 5, 6 (2006).

[170] DANIEL L. RUBINFELD AND SUZANNE SCOTCHMER, *CONTINGENT FEES FOR ATTORNEYS: AN ECONOMIC ANALYSIS*, 24(3) THE RAND J. OF ECON. 343, 350 (1993).

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2.2.3. Incentives in the principal-agent framework[171]

A general consequence of principal-agent theory is that, when the effort is unobservable, a payment mechanism which rewards the outcome of the effort rather than the effort itself will be more efficient.[172] The lawyer's goal is to maximise the payment for his services minus the cost that he incurs in the process. When the payment system is based on efforts, the lawyers internalize the cost of their efforts but not the results. In such an efforts-based payment system, they have incentives to put in inadequate efforts. Because the lawyer's pay is largely unaffected by the outcome of the case, it leads to inefficiency and market failure.

Consequently, it will be more efficient to award the lawyer for his productive efforts which can be done by giving him a stake in the outcome of the case. This will align the interests of the lawyer and the client. Both the lawyer and the client will be better off since it will give the lawyer an incentive to put it in higher efforts which in turn, will help the client recover a larger amount. The same is graphically exemplified as below.

Let, x=lawyer's effort level; A = award, Pp = probability with which litigant expects to win the case[173]and Cp = the costs incurred in litigation.

The expected value[174] of trial for the litigant =APp(x) – Cp(x),
where Pp(x) and Cp(x) are increasing functions of x since it is assumed that the probability of success at trial depends on his lawyer's effort level.[175]

Costs at trial are incurred by the lawyer. The optimal effort level will be x*, where the difference between costs incurred and the expected value of the amount recovered is the highest. Under fixed fee system, the lawyer will get remunerated irrespective of his effort level, giving him incentive to minimize his efforts. Under contingency fees system, the

[171] R.S. Pindyck et al, MICROECONOMICS, 583 (7thedn., 2009).
[172] Rickman, *supra* note 165, at 37.
[173] Francisco Cabrillo and Sean Fitzpatrick, THE ECONOMICS OF COURTS AND LITIGATION 165 (2008).
[174] Expected value is probability weighted average of the payoffs associated with all possible outcomes. *See,* R.S. Pindyck et al, MICROECONOMICS, 597 (7thedn., 2009).

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lawyer is given a stake in the outcome of the case, denoted by *b*. A rational lawyer will choose an effort level to maximize his own returns. Therefore, the lawyer maximizes bAPp(x) – Cp(x), which will lead to a positive effort level, *xb*.[176]

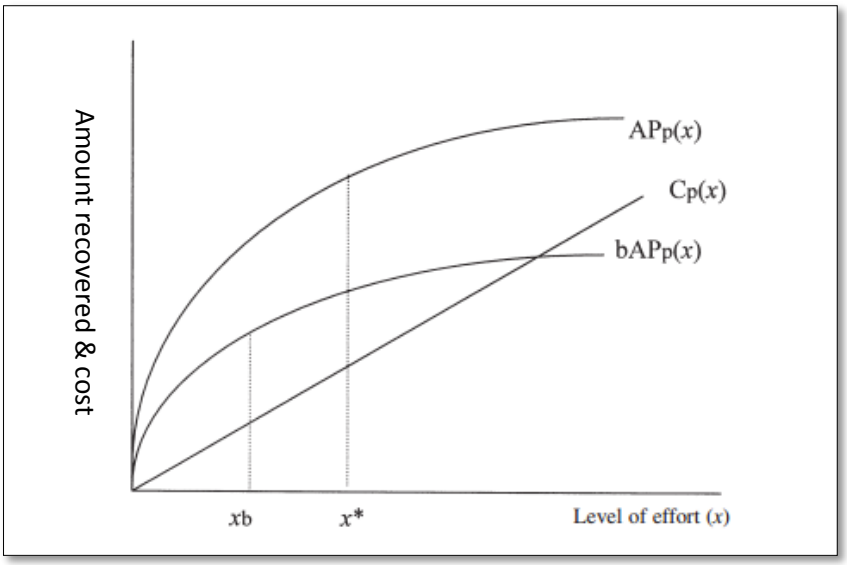

Figure 1: Contingent Fees and Lawyer's effort[177]

2.3. RISK-SHARING

Contingency fee arrangements act as risk-sharing instruments in as much as they shift the risk of negative returns from litigants to the lawyers. It is based on the assumption that lawyers are risk-neutral since they work on multiple cases at once. For a client, all his risk is associated with one case but a lawyer invests his time and efforts in several cases at once, the outcomes of which are usually not correlated, allowing him to diversify the risk.[178]Also, lawyers, with their expertise are better equipped to assess the prospects of a case and the risks associated with it. Shifting uncertainty away from a risk-averse client to a risk-neutral lawyer leads to more efficient allocation of risk and higher social welfare.

This can also give way to the lawyers 'buying' the claim from their clients, which is the most optimal solution to the principal-agent problem. Figure 2(b) shows the utility curve of risk-averse client. I_W is the amount of recovery on winning the case while on losing,

[175] *Id.*
[176] *Id.*
[177] *Supra* note 173 (Graph).

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nothing is recovered (I=0). Line OA shows the total expected utility derived from pursuing the claim. The expected outcome is I_E which gives an expected utility U. To receive the same level of utility, the client is willing to give up the claim for a certain amount of I_1 (the fixed sum which lawyer will pay the client to buy the claim from him). Figure 2 (a) shows the risk-neutral lawyer who is indifferent between his actual utility and expected utility. With an initial income level of I, he will be willing to buy the case when $I-I_1+I_E > I$ or $I_E > I_1$.The utility loss of risk-averse client from lower payoff will be offset by utility gain from certainty. It is a Pareto efficiency gain since the lawyer is better off without the client being worse off.[179]

However, such 'buying' of claim can cause the insured plaintiff to lose interest in the claim which can deprive the lawyer of his necessary cooperation;[180] nor is it permissible in India.

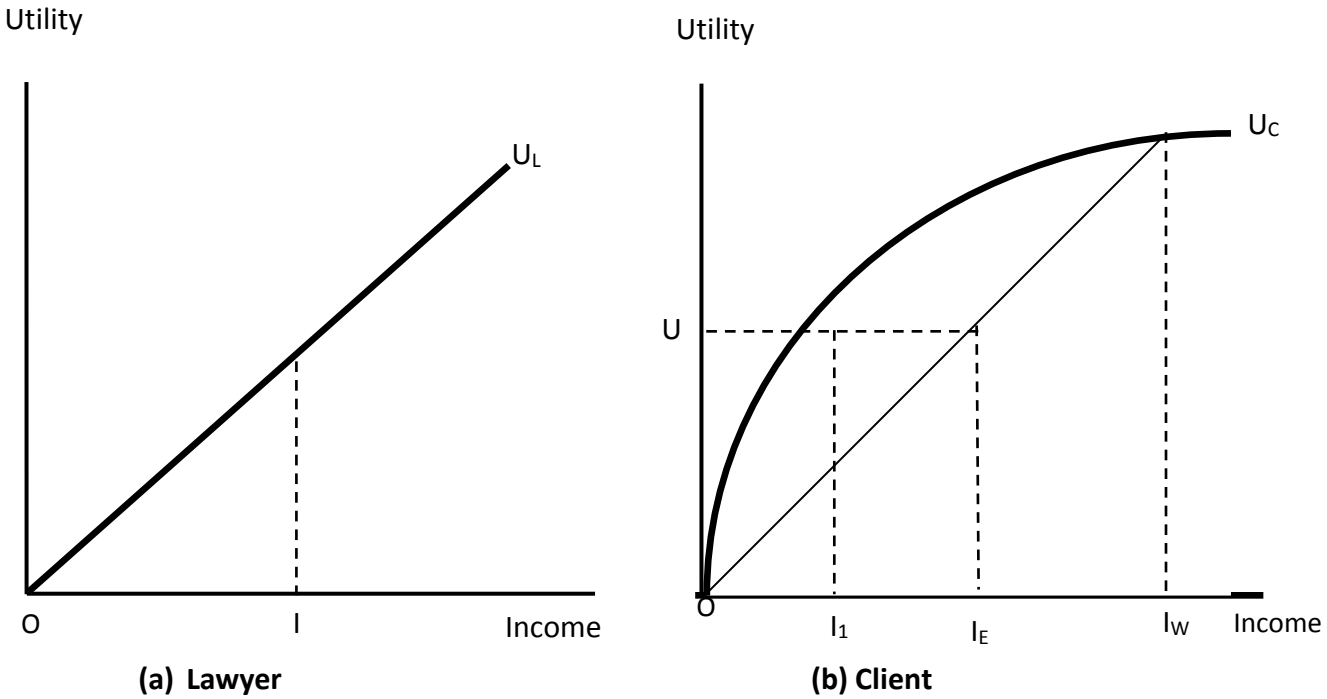

Figure 2: Risk sharing between risk-averse client and risk-neutral lawyer[181]

[178] Diversification is the practice of reducing risk by allocating resources to a variety of activities whose outcomes are not directly related.

[179] Rickman, *supra* note 165, at 38.

[180] Patricia Munch Danzon, *Contingent Fees for Personal Injury Litigation*14(1) THE BELL JOURNAL OF ECONOMICS 213, 220 (1983).

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III. IMPACT ON LAWYERS

3.1. THE CONCEPT OF RISK

For a lawyer, a contingency fee arrangement acts as a risky asset, yielding income if the trial is successful.[182] The riskier an asset is, the higher will be the expected return on it. This is analogous to the concept of finance where riskier investments command higher return rate.[183]Therefore, contingency fee will generate higher returns for the lawyer as a compensation for accepting the risk of being inadequately paid for the services provided or of not being paid at all. The lawyers will charge not only for their efforts they put in but also for bearing the risk. Under contingency fee arrangements, the lawyer has to bear the following risks –

1. Getting an inadequate award which is unable to meet the costs, though the case is won.
2. The absence of payment when the case is lost.
3. The compensation is adequate but the defendant is unable to pay it.
4. Laws in question change to the disadvantage of the plaintiff while the case is pending.

The aforementioned possibilities constitute the risk element in lawyer's fees which entitles him to charge a rate higher than normal.

3.2. ENTRY TO THE MARKET

Contingency fee can enhance the business prospects of a new entrant in the legal services market. As established in Section I, price sensitive clients who cannot afford paying the high fee of established lawyers can avail to this payment mechanism and create a prospective client base for a new lawyer. It also allows the clients to partner their risks with the lawyers which can attract risk-averse clients who refrain from instituting a suit due to the risks involved. Further, these arrangements can address the information

[181] Rickman, *supra* note 165, at 38.
[182] A risky asset is an asset that provides an uncertain flow of money or services.

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asymmetry concerns of the client who can now rely on a lawyer whose interests are aligned with those of the client and who will put in efforts in furtherance of a common intention. This will help a new lawyer who will find it relatively easier to win a client's trust.

IV. IMPACT ON THE COURT MACHINERY

4.1. FRIVOLOUS LITIGATION

Contingency fee can help in reducing frivolous litigation. Under hourly or fixed fee arrangements, lawyers bear little risk which may induce them to take cases which are largely meritless. However, under contingency fee, lawyers bear a greater risk, which can discourage them from taking cases that have no merit. By resting lawyers' compensation on the success of the case, they are given an incentive to function as gatekeepers of the court machinery. They can assess the cases for their merit and will pursue only those which are likely to succeed.[184] This is based on the assumption that lawyers have greater knowledge and expertise to determine the merits of the case and likelihood of its success than the clients. Indian judiciary is already burdened with 88,53,981 pending civil cases.[185] Allowing contingency fees arrangements will address the problem of frivolous and vexatious litigation to an extent.

4.2. LEGAL AID

Contingency fee mechanism helps in sharing risk between the public purse and lawyers since it reduces the costs of legal aid.[186] In India, free legal services are provided under Legal Services Authorities Act, 1987. Legal Services Authorities provide the eligible applicant with counsel at the expense of State, pay the required court fee and all other

[183] Shajnfeld, *supra* note 160, at 777.
[184] *Id.*
[185] NATIONAL JUDICIAL DATA GRID, http://njdg.ecourts.gov.in/njdg_public/main.php (Last visited on June 4, 2019).
[186] *Supra* note 173, at 170.

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incidental expenses related to the case. The person endowed with legal aid, therefore, is not required to pay anything for the litigation.

Figure 3 below shows the budgetary allocation for National Legal Services Authority to provide legal aid to the poor and disadvantaged. Apart from budgetary allocation, the 13th Finance Commission awarded a special grant of Rs.300 Crores over a period of five years (2010–2015) for legal aid scheme. However, only Rs.68 Crores of the allocated budget has been utilised which shows inefficiency on the part of the government.[187]The government, by allowing contingency fee, will substitute the need of funding free legal aid and still solve the access-to-justice problem in cases which involve damages to be recovered, as explained earlier.

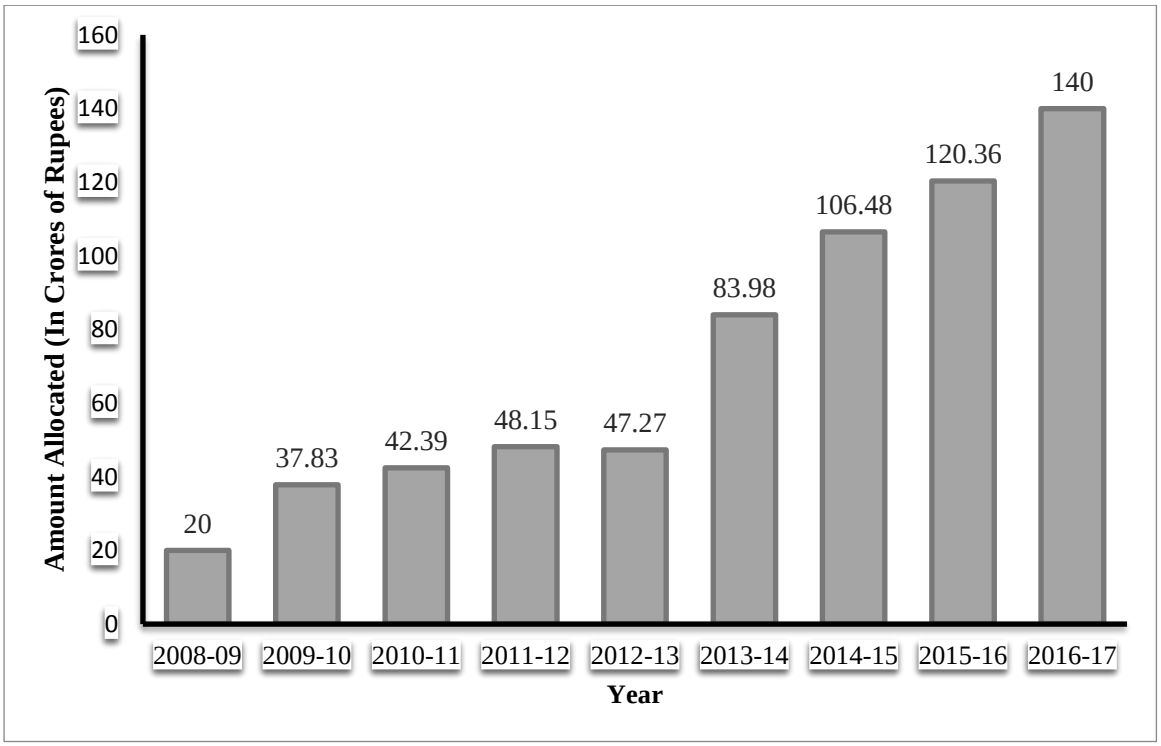

Figure 3: Union Budget Allocation for the National Legal Services Authority[188]

[187] *Improving Justice Delivery: Ready Reckoner on Thirteenth Finance Commission Grant, Government Orders and Guidelines Issued by the Government of India* (2011), MINISTRY OF LAW AND JUSTICE, http://doj.gov.in/sites/default/files/READY%20RECKONER%20TFC%281%29_5.pdf (Last visited on June 4, 2019).

[188] Sources of Funding, NATIONAL LEGAL SERVICES AUTHORITY, https://nalsa.gov.in/content/funding (Last visited on June 5, 2019).

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V. THE SHORTCOMINGS

This section discusses the problems that allowing contingency fee arrangements can pose. They require the lawyer to be sure that the cases they take have sufficiently high expected value which can cover the opportunity costs of their time and risk-bearing. Consequently, the cases with high expected value will be viewed more favourably by them over the ones which do not have these characteristics.[189] This challenges the access-to-justice justification of contingency fee.

Another argument is that instead of aligning the interests of lawyers and clients, contingency fee present each with different incentives. This can prejudice the lawyer's advice on important decisions such as whether to file a case or to settle it. As the lawyer pays the costs of the case, he may be tempted to settle the case early before running the risk and costs of going to trial.[190] This may work against the client's interests. Conversely, the client may wish to settle early in need of money while the lawyer may want to delay it in hopes of greater recovery.

Contingency fee can also induce 'ambulance-chasing' behaviour in lawyers. Ambulance-chasing is a blatant form of solicitation in which a lawyer uses undue pressure to persuade injured people to employ the lawyer to represent them. Contingency fee system would incentivise lawyers to actively seek cases now that they have a direct financial interest in the outcome of the case.[191]

Further, plaintiffs may be encouraged to try their chance with any kind of claims since contingency fee shifts the risk of negative outcome to the lawyer. Encouraged by this, some advocates, in the hopes of obtaining an early settlement may overlook the strength assessment of a case and file frivolous lawsuits.

[189] Rickman, *supra* note 165.
[190] *Id.*
[191] *Id.*

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Contingency fee arrangements have also raised ethical concerns. Direct financial interest in case may cause an advocate to abdicate his responsibility towards the court. Another apprehension, especially in Indian context is that it may lead to exploitation of clients with lawyers, superior in skill and knowledge, charging exorbitant fee and unlike in developed nations, the literacy and awareness level of clients in India are low.

VI. CONCLUSION

This article studied the implications of allowing the lawyers in India to charge contingency fee. Largely, this system tends to make the legal services market more efficient. It provides a solution to the access-to-justice problem, thus increasing the social welfare. It corrects for the market failure arising out of information symmetry and principal-agent problem and leads to efficient allocation of risk between the risk-averse client and risk-neutral lawyer. However, this result may change where the clients have different preferences toward risk. These justifications of contingency fee promote consumer welfare.

Contingency fee arrangements allow the lawyers to charge higher fee as a compensation for the risk they bear. This however, can also tempt them to exploit clients who have lesser knowledge. Prohibition on contingency fee serves as a barrier to entry in legal market; allowing them can be advantageous for a new lawyer. Further, contingency fee can help reduce frivolous litigation and can also substitute the legal aid which the government in India has otherwise not been very efficient in providing. Therefore, contingency fees can help promote social welfare.

While the arrangement has its shortcomings, regulations in terms of regulating the type of cases where lawyers can charge contingency fees and fixing a maximum percentage of recovery as fees can help overcome them. A deeper study of the existing models of contingency fees in countries like the USA can help draw valuable inferences and understand the implications of such mechanism in India better.

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Contingency fees system can be introduced in India with regulations in order to maximise welfare of the stakeholders. The regulations can be specifying or limiting the kind of cases in which contingency fee can be charged. For instance, in the U.S., contingency fees is barred in criminal suits and domestic relations matters such as divorce.[192] The regulations can also prescribe the percentage of contingency fees that can be charged. These regulations largely stem out of ethical considerations, with the objective of promoting social welfare. Economic impact of such regulations in India are out of the scope of this essay but must be explored in future before a system of contingency fees is brought in.

Thus, contingency fees arrangements can prove to be useful and important provided they are structured in a way to maximise the advantages and minimise perverse incentives and effects. This would promote an economically efficient market for legal services in India.

[192] Rule 1.5(d), American Bar Association Model Rules of Professional Conduct.

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