THE SOCIAL BENEFITS OF ENHANCING THE USE OF ALTERNATIVE DISPUTE RESOLUTION MECHANISMS: AN INTRODUCTORY ECONOMIC APPROACH

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Abstract: The first part of this paper shows that solving social conflicts through Alternative Dispute Resolution (ADR) makes society economically and socially better-off than solving problems through the judicial system. The second part of this work shows how the Rule of Law can be enhanced by the use of ADR and how these two institutions interact and reciprocally enhance each other. The effects of the reciprocal relationship between rule of law and ADR are analyzed through an economic approach. The research was done using deductive methodology and bibliographic exploration.

Keywords: Alternative Dispute Resolution; Economic Growth; Rule of Law; Economic Analysis of Law.

OS BENEFÍCIOS SOCIAIS DO USO DE MÉTODOS ADEQUADOS DE SOLUÇÃO DE DISPUTAS: UMA ABORDAGEM ECONÔMICA INTRODUTÓRIA

Resumo: A primeira parte deste artigo busca mostrar que a resolução de conflitos por meios de Soluções Alternativas de Disputas (ADR) torna a sociedade economicamente e socialmente melhor do que a resolução desses mesmos problemas por meio do sistema judicial. Na segunda parte do trabalho é introduzida a ideia da *rule of law* e os meios pelo qual esta instituição pode ser

melhorada com um aumento do uso de ADR, bem como a natureza da melhora recíproca causada pela interação dessas duas instituições. Por fim, os efeitos da interação entre *rule of law* e ADR são analisados por uma abordagem econômica. A pesquisa foi realizada utilizando método dedutivo e exploração bibliográfica.

Keywords: Soluções Alternativas de controvérsias; Crescimento Econômico; *Rule of Law*; Análise Econômica.

INTRODUCTION

xcess or excessive judicial litigation has been considered an issue of general concern to mostly every nation in recent decades. This problem is more significant for some nations than for others, and sometimes the biggest problems are in places one would not expect.

Take Japan as an example. The 'land of the rising sun' is well known as a country "that does not litigate"[1], but in 2008 2,372.84 new civil and family suits per 100,000 population were filed[2]. England and Wales courts received, in 2009, 3,889.05 new civil and family suits also per 100,000 population. On the same trend, in 2009, 2,271.10 proceedings per 100,000 population were filed in Canada. France's courts received, in 2006, 3,100.57 new lawsuits per 100,000 population. In the United States, in 2007, were filed 7,925.63 per 100,000 population. And finally, in Brazil, the litigation champion of this list, in 2009 9,974.60 new civil and family suits per 100,000 population[3]

[1] See: Haley, John (1978). The Myth of the Reluctant Litigant. *4 J. JAPANESE STUD. 359, 389.* ("Few misconceptions about Japan have been more widespread or as pernicious as the myth of the special reluctance of the Japanese to litigate.").

[2] We present statistics related to population rather than absolute numbers, because we believe this kind of comparison better represents the level of litigation.

[3] The methodology, and even some data, used to achieve these rates were similar to

were filed.

This growth in litigation represents an increase of government expenses (as well as an increase in court backlog) and, as a response to that problem, policy makers from countries with high rates of litigation have in the last decades created policies and laws intended at controlling or at least decreasing rates of judicial litigation.

A not so recent idea is that this problem (the increase in litigation and associated increase in expenses and backlog) can be solved through the use of Alternative Dispute Resolution (ADR) mechanisms, which, put in a simple way, can be thought of as ways of solving social disputes other than the use of the Judicial system.

While the idea that ADR may solve the problem of overburdened courts is generally accepted by most people, some scholars claim the use of Alternative Dispute Resolution should not be a public policy goal, because these alternative ways of solving conflicts could create "social unfairness" or even increase the rates of litigation in long term[4].

On the other hand, other authors, favorable to ADR, affirm that to increase the usage rates of these alternative ways of solving conflicts it is necessary to change the "litigation culture"[5] of a country. There is also extensive literature that

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those used by Ramseyer and Rasmusen (2010). However, here the rates of litigation were based in all the commenced civil and family law cases, not just civil cases. For the United States data it was considered civil litigation at Federal level. For England and Wales we considered the data from private law suits involving children, dissolution of marriage, nullity of marriage and judicial separation. For Brazil, which has a classification of jurisdiction similar to France, labor issues were considered as civil cases, like everywhere else. The annex I shows in more detail the data and sources from which we extracted data.

[4] These two ideas are well approached by Owen Fiss (1984) in his classical article "Against settlement". Also, Wayne Brazil (1998) express the same concern to ADR: "Some judges and judicial administrators, for example, might be attracted to ADR only or primarily as docket reduction tool, posing serious threats to fairness or other values that ADR should be promoting".

[5] Or even the way how law has been taught at law schools. See Alex Zamboni´s

prescribes the necessity of clear rules and incentives to parties in order to make them settle outside the Court system[6].

The causes to excessive litigation are of a varied nature. In Brazil, for example, if a person can meet a light burden of proof that her income is low, she´ll be able to file a suit without paying any fees or costs[7]. Furthermore, the State may provide legal assistance - sometimes the claimant won´t even need to be represented by a lawyer (small claims can be filed without the assistance of a lawyer)[8]. Some of the questions this set-up of rules arise are related to the incentives generated toward the willingness of the party (who will not bear any judicial costs) to file a lawsuit and at a later moment settle (or not) a judicial case. Is this policy/law creating incentives for the party to settle or to litigate and to what extent[9]?

The answer seems obvious but deserves some refinement, to be done in this paper, which will also show that Alternative Dispute Resolution (ADR) are socially and economically better than litigation for solving disputes, and that the use of the former can be enhanced when components of the rule of law are well-defined.

To do so, in the first part of this work it will be shown that any controversy that cannot be solved by the parties and

analysis of Brazilian pilot laws regarding to ADR and its inefficacy, since the culture of litigation were still being taught at the law schools and to lawyers.

[6] The classical view of Law and Economics claims that people will change their behaviors if there is a concrete incentive toward that.

[7] Court fees are suspended and can be recovered by the state up to 5 years after the sentence is rendered if the assisted party is condemned, but only if a change on the financial situation of the party happens (this practically never occurs).

[8] Art. 9 of the law n. 9.099/1996.

[9] Steven Shavell (The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System. *The Journal of Legal Studies, 26*(S2), 575-612. doi:10.1086/468008) reminds us that *"The legal system is an expensive social institution"* and that the amount of litigation then happening was not *'socially appropriate'* because there were *"fundamental differences between private and social incentives to use the legal systems"*. He claims that this is because a party *"does not take into consideration the legal costs that he induces others to incur"* nor *"recognize associated effects on deterrence and certain social benefits".*

requires third party intervention constitutes a transaction cost[10] and that the use of ADR usually presents a better cost-benefit alternative (and almost always a faster one, even if more expensive). We will also demonstrate that the wealth saved by the shift from the judicial system to ADR benefits not only the parties but also society, as the new uses of this saved wealth can boost economic growth and society's quality of life.

The second part of this paper will deal with the question of how a well-defined set of rules enhance the use and benefits of ADR – more so than the Judiciary. To do so, we will introduce some ideas developed in the "optimistic model of litigation" designed by Robert Cooter[11] and then demonstrate how the application of these ideas can enhance the use of ADR, the effectiveness and application of the rule of the law and why this is a good thing.

PART I – WHY ENHANCE THE USE OF ALTERNATIVE DISPUTE RESOLUTION MECHANISMS?

It is well accepted that Alternative Dispute Resolution (ADR) mechanisms, if compared to the judicial system, are (sometimes) cheaper, (sometimes) faster, more technically precise and allow more tailored options for parties to solve disputes[12], being considered (in The United States and elsewhere) as the most efficient and important way to solve social

[10] If the controversy arises out of a voluntary transaction, then it is a transaction cost; if it arises out of a non-voluntary issue, such as a tort, it is then a cost of other nature, but nevertheless a cost.

[11] On the classic article "Bargain in the Shadow of Law".

[12] Taking apart arbitration, which can be thought of as "litigation with specialized judges and with a faster procedure", and though it is defended that arbitration presents a better cost-benefit than litigation in the long term, the other forms of ADR disregard discovery, which is, indeed, the most expensive part of any judicial dispute (see all this idea at: Folberg; Golann; Stipanowich; Kloppenberg (2016). *Resolving Disputes: Theory, Practice, and Law*. 3th Ed. Aspen Publisher. p. 547-552) and Timm (2017).

disputes[13].

However, the literature supporting the advantages of ADR usually analyzes only the advantages for the parties on the dispute. Very few of the works we consulted were concerned with demonstrating and measuring whether society would be economically and socially better-off using ADR in comparison to judicial litigation[14]. It is fair to assume that parties to the controversy benefit from the use of ADR, but the question if society also benefits from the use of ADR has not been fully answered.

For example: If a party to the conflict (or parties, if there is settlement) decide(s), after the resolution of a dispute, to go out to celebrate its/their "victory" and purchase a car that costs $50.000,00, is society benefiting[15]? Apparently not, because if the parties had solved their dispute through litigation, there would still be money for new cars purchases – this time by the lawyers[16] instead of the parties themselves. Intuitively, one could think that the use of ADR would be neutral to society, a 'zero-sum game'. Society would not be any better or worse-off with either the use of ADR or of the Judicial system.

We believe that this conclusion is wrong. Even though the example above may reasonably create the idea that the outcome would be socially neutral, ADR actually makes society better-off, because if we consider that the judicial system

[13] To know more about the enhancement of ADR in U.S., see: Galanter, Marc (2004). The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts. *Journal of Empirical Studies*. V. 1. Issue 3. See also: Judicial Council of California/Administrative Office of the Courts (2004). *Evaluation of the Early Mediation Pilot Programs*.

[14] See the question, "would society be better-off or worse-off through ADR?" at: Folberg; Golann; Stipanowich; Kloppenberg (2016). *op. cit*. p. 14.

[15] Assume that the joint benefit (compared to litigation) is $ 50.000,00.

[16] In real world the trial expenses are shared with agents of justice and others, such as experts brought in trial, for example. In the example above, we opted to use only the attorneys to simplify the idea that expenses incurred by someone in trial are just a typical 'opportunity cost', in a sense that they are being paid to these agents of Justice and not used elsewhere (the opportunity). In the example lawyers' fee in litigation are the exact same value saved by the use of ADR.

represents a high transaction cost, the shift from the judicial litigation to ADR would lower the opportunity cost of solving disputes[17]. This means a twofold benefit. First, ADR use is better because ADR adjudicators are better prepared to do their jobs (more technical in arbitration, more skilled in other techniques) and are not (in most cases) bound by the rules of federal civil procedure. Judiciary cannot compete or improve (at least in Brazil), because judges are bound to current rules of civil procedure, but also due to the generalistic nature of their progression in the career – it is hard to find specialization – and due to the current process of admission of new judges.

Second, if the wealth saved remains with the parties, especially if they're business entities, their use of the savings will probably be more efficient that if the corresponding amount was attributed to the state (court fees) or to agents of the court (litigation expenses).These savings can be put to productive uses that lead to creation of new products and improvement of existing ones. In other words, economic growth and society's quality of life would be increased.

To understand this statement, the reader needs to have a general idea of what constitutes the wealth of a society. Because the wealth of a society could be measured in diverse ways, we opted to use a simple measure - Gross Domestic Production (GDP)[18]. We will demonstrate what composes GDP, how it is increased by the creation of new and diverse products[19], what is

[17] See Luciano Benetti Timm. Análise econômica da arbitragem. https://lawle2014.files.wordpress.com/2017/10/timm-10042016-aed-da-arbitragem-livro-tarcicc81sio-lmj.pdf

[18] To know more about GDP, see: Kuznets, Simon (1934). National Income, 1929-32. *National Bureau of Economic Research*. Strictly defined, GDP is the sum of market values of all goods and services consumed and invested in an economy during a period of time.

[19] For a deeper analysis about the enhancement of economic growth through new products creation, see: Jorgenson, Dale; Ho, Mun; Samuels, Jon (2014). *Long-Term Estimates of U.S. Productivity and Growth*. See also: Ayres Robert (1989). Technological Transformation and Long Waves. *International Institute for Applied Systems Analysis*.

quality of life (and also how to enhance and diminish it), what are the transaction costs[20] that lower GDP and how judicial litigation and ADR are related to all these subjects. We opted to demonstrate these concepts with the use of some simple examples.

We start by explaining Gross Domestic Production (GDP) and how it increases or decreases. We use a very closed and small economy to make the example easier. Suppose a nation (x) has a total of 4 people that only grow and produce potatoes and each person consumes only 1 potato in a time (y) (assume they could consume more things if those were different from potatoes[21]), but produces 2 potatoes on this nation at the same time (y). The total production of this nation is 8 potatoes, of which 4 would be consumed and other 4 would be stocked.

GDP is generally thought of as the sum of everything produced by a nation, but that is not fully correct. GDP is actually measured by the sum of all things consumed and invested[22] by national and international players, including government[23]. Therefore, because the example here is related to a closed nation and the potatoes stocked cannot be consumed or invested (no one in this country wants to consume more potatoes), the GDP of the nation (x) would be only 4 potatoes.

GDP also increases when new products are created and offered in the market. Suppose now that instead of having 4 persons producing only potatoes (2 potatoes each), one of these

[20] See the general idea of transaction costs at: Coase, Ronald (1960). The problem of Social Costs. *The Journal of Law and Economics*.

[21] The idea of "the more you have regarding to something, the less you want it, and the less you have regarding to something, the more you want it", well illustrated in the example by a person that is saturated with potatoes, but could consume other things, is in accordance with utilitarian theory. See: Fishburn, Peter (1970). *Utility Theory for Decision Making*. John Wiley & Sons. Inc.

[22] Since it is the consumption of things to create and upkeep capital goods or income producing properties.

[23] See the summary of the GDP formula at: Encyclopedia Britannica: https://www.britannica.com/topic/gross-domestic-product. Retrieved on 28th June. And the original formula at the report cited above: Simon (1934).

persons gets tired of producing potatoes and obtains the knowledge to start producing wheat and making bread (new product) out of the wheat. Assume that this different player produces 2 loafs of bread and that his personal consumption is only 1 bread (but he could consume more food, just like the potato producers, if there was the opportunity to consume things other than bread[24]). In this new setting, this nation would have produced 8 units of product - 6 potatoes and 2 breads, just like the first example. However, the GDP of this nation would be higher because the bread producer can trade with the potato producer one stocked bread for one stocked potato. If that was the case, GDP would increase to 4 potatoes and 2 loafs of bread, 6 items (the trade would result in the consumption of one extra bread and one extra potato). Given our assumption that the price of a potato is equal to the price of bread, this new situation would increase the GDP of the nation (x) by 50% simply by changing the production of potato to bread (a new product). Diversity matters.

Let's now add a new component of complexity: the idea of quality of life. Quality of life has multiple definitions and measures, subjective ones (such as happiness[25]) and objective ones (a person with ownership and rights of use to a boat, a car, a house, food, access to health services and no debts has – or at least is usually thought of having - a better quality of life than a person without a similar house, no food, no access to health services and debts, at least from a majoritarian perspective)[26]. Since the subjective standard for quality of life tends to be a moralistic and abstract proxy, it will not be of concern to

[24] Same as the idea discussed on the footnote 16.

[25] Examples of abstract definitions for quality of life are: Human Development Index and World Happiness Report. See those respectively at: United Nation Development Program and Helliwell, Layard, & Sachs (2018).

[26] The objective definition of quality of life is related to the quantity of GDP per capital of a nation, in other words, the quantity and quality of things consumed. The more you consume, better your quality of life is.

this work, but having an objective standard to measure quality of life is an important part of our argument.

Analyzing the situations related to the examples above, it can be agreed that the society with the bigger GDP also has the better quality of life, and that is not just because of the higher GDP, but because on the second nation there were two, of the four people, who consumed not just potatoes, but also bread, resulting in more quality of life/more utility[27]. Again, diversity (access to different options) matters.

Next, there is the idea of transaction costs. To understand the concept, a little bit of complexity must be added to the example. Suppose now that nation (x) has two potato producers (and each one produces now 3 potatoes), a 'for hire' peacekeeper (his activity is to compel people to keep the order – or restore it, once broken) and a thief. Initially, the GDP of this society is 2 potatoes, while 4 potatoes are stocked and not part of GDP (while 6 are produced, only 2 are consumed). Imagine now that the thief, knowing about the stock of potatoes, steals 2 potatoes from one of the potatoes' owners. Before the thief can eat one of the potatoes, the stolen potato owner hires the peacekeeper (for the cost of one potato) to catch the thief. The peacekeeper executes his service perfectly, getting one potato back to its rightful owner and maintaining one to himself (his payment).

In this setting, production is now 6 potatoes and 1 peacekeeper service, while GDP is 3 potatoes and 1 service of the peacekeeper. Looks like the total outcome on this third example is better than the initial situation (without the action of the thief), mainly because GDP increased from 2 potatoes to 3 potatoes and 1 service, a 100% enhancement on the GDP (assuming, for simplicity purposes, the service of the peacekeeper has the price of a potato).

However, the potato owner's consumption of the peacekeeper services did not mean an increase on his wealth or utility

[27] The notion of utility used in this work does not refer to the utilitarian approach.

(if compared to the initial situation). Even though he voluntarily consumed the peacekeeper services, this service is a typical transaction cost, because its only purpose was to get back the two potatoes stolen by the thief[28]. In substance, the transaction with the peacekeeper was analogous to a (unwilling) "donation" of one potato, that is to say, the potato's owner did not have an additional gain (he just avoided a loss).

In addition, in this last example society would be actually economically and socially better if the thief and the peacekeeper, instead of robbing and combating crime, had produced, for example, 2 loafs of bread the first and 2 bushels of corns the second (assuming also that each would consume one corn and one bread and exchange the remaining with the others[29]). This new setting would account for the "best" social scenario among all the ones seen so far, because the people would have consumed everything produced in this nation, resulting in a GDP of 4 potatoes[30], 2 breads and 2 corns (8 items produced and consumed), a 100% increase when in comparison to example 1 (where 4 potatoes' producers grew 2 potatoes each and only 4 potatoes were consumed). Perhaps even more importantly, every person in this new situation would have eaten more than one item (For example: 1. potato-bread; 2. potato-corn; 3. corn-potato; 4. bread-potato) which presumably means an increase in quality of life and not only an increase in economic terms.

However, to arrive at this best situation, thieves should not exist, and in their absence, there would be no need for

[28] Though it was considered here that the peacekeeper service is a transaction cost, some authors from economics claims that this type of work could be also considered a rent-seeking activity. See for example: Murphy, Kevin; Shleifer, Andrei; Vishny, Robert (1991). The allocation of Talent: Implications for Growth. The Quarterly Journal of Economics. V. 106. N. 2. And a general discussion on rent-seeking activities and transaction costs at: Murshed, S. (2001). Transaction Costs Politics, Institution for commitment of Rent-Seeking. UNU World Institute for Development Economics Research (UNU/WIDER).

[29] Just like the potato producers.

[30] Assume that each potato producer has produced only 2 potatoes.

peacekeepers, and both the former thief and the former peacekeeper would be free (and need) to produce something of value. The production surplus, if existing, could be exchanged with others that also had resources stocked.

Likewise, if a person spends more and more his "stocks" (his savings) on things of a nature similar to a peacekeeper's services (transaction costs), society will see a reduction on economic growth and quality of life. A nation with a high number of people offering services similar to the "peacekeeper" is worse-off than one that does not have the need for such services[31], not only because of the negative aspects of the thief's 'products', but because neither thief nor peacekeeper are actually producing things that maximize the wealth of society[32].

What does all of the above have to do with ADR? A lot, and we can now draw a parallel toward the judicial system and explain our thesis regarding ADR and its social benefits.

First, we can draw an analogy: peacekeeper services are of a similar nature to services offered by lawyers, prosecutors, clerks, judges, etc. (the judicial system), services that depend on the existence of 'wrongdoers'[33]. Because agents of justice only work to compensate harm to others, enforce breached contracts and things of the like, they are not adding wealth to society (in fairness, they are preventing wealth loss, but that is second best to adding wealth).

Second, if it is possible to reduce the costs (not only financial ones) of using the judicial system by solving disputes in a less bureaucratic and efficient way (ADR), society will actually be "better-off", because the decrease on money spent

[31] And not only because of the absolute number, but because of the need for the services provided.

[32] They are just taking part of the production of others, whether voluntarily (peacekeeper) or not (thief).

[33] The idea of wrongdoer applies not only to persons that committed crimes, but, also include ones that have not fulfilled its contractual obligations or others that violate third party's rights and privacy.

(and/or gain on time) with judicial litigation would mean not only a gain to the parties involved, which can put this gain to good use, but also a shift in people offering this service[34] to more productive uses of their time and capabilities. In other words, a consequent allocation of human capital to areas that 'produce new products'[35] and generate social wealth.

Besides, even if the shift in the expenses from the judicial system to ADR[36] does not change the number of people working on dispute resolution (an unrealistic assumption), ADR represents a 'better cost-benefit' "transaction cost"[37] (or in other words, a lesser transaction cost) than the judicial system, which means that the use of ADR will save more wealth than judicial litigation, wealth that could be allocated to other economically productive areas. That's why we make a claim that the use of ADR will generally make society economically and socially better-off than the use of the judicial system. Of course, this claim assumes that ADR represents a more cost-benefit effective alternative than the use of Judiciary.

PART II – ENHANCING ALTERNATIVE DISPUTE RESOLUTION THROUGH THE OBSERVANCE OF A STABLE AND PREDICTABLE SET OF RULES (THE RULE OF LAW).

In this part we will deal with the relationship between

[34] Supply and demand (Say's law). See: Jean Baptiste-Say (1803). *A Treatise on Political Economy: production, distribution and consumption of wealth*. Augustus M. Kelley Publishers.

[35] In United States, for example, it can be assumed that someone that can be educated to be a lawyer could also choose to be an engineer or open a business and create new products.

[36] Notice either that no emphasis was given regarding the differences of outcome (recovery) through the litigation system or through settlements by ADR. It is assumed that the plaintiff will receive the same amount through both systems, which may not be a realistic assumption is some cases.

[37] Litigation and ADR are both transaction costs because both are means for solving conflict between parties.

ADR enhancement and the improvement of the rule of law. We first introduce some ideas developed by Robert Cooter (and others) when they developed the "optimistic model of litigation" on the classic article "Bargaining in the Shadow of Law"[38]. Focusing on a specific idea developed at that paper, we will analyze that relationship with examples about the application of the rule of the law, using an economic approach we believe to bring relevant insights.

In his famous article, Robert Cooter analyzes some causes that influence parties' decision (variables) to litigate instead of bargaining/settling. The author divided the variables in two groups: (i) those that subjectively influence settlement rates (psychological variables that depend on the emotions of the parties) and (ii) legal institutions (variables controlled by law) that influence the "game players" in their decision to settle or to pursue a trial judgment.

Initially, there are variables that increase or decrease the likelihood of settlement[39], as follow: a) urgency for a solution by the parties (it increases the likelihood of settlement); b) improved value of trial for one litigant (trial's expected outcomes are different for the parties, what decreases likelihood of settlement); c) increase in transaction costs of negotiation, which enhances the urgency to solve the dispute (increases likelihood of settlement); d) increase of transaction costs on trials (increases likelihood of settlement); e) increase in earnings per period contingent on no resolution of the dispute (decreases likelihood of settlement); f) increase in spitefulness toward opponent (decrease settlement); g) less risk aversion by one or both parties (decrease settlement); h) increase in the familiarity of opponents, in case of repetitive disputes with the same parties (increase settlement).

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[38] See: Cooter, Robert (1982). Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior. *Berkeley Law*.

[39] See all the predictions and legal institutions at: Cooter, Robert (1982). *op.cit*. p. 238-240 and p. 242-243.

The article then describes the legal institutions that affect the rates of settlement, such as: a) increase on the use of governments' institutions, the judiciary, when the external bargain costs (transaction costs) are high; b) increase of settlement by the insertion/existence of Rule 998 of the California Code of Civil Procedure (or the rule 68 of the United States Rules of Civil Procedure[40]), which creates incentives to the parties to bid for settlement in good faith, and; c) pessimistic parties are more attracted to litigate in the American Judicial system than the British judicial system (and also the European civil law system), because the loser on the British system bears the costs of litigation incurred by the winning party.

It is easy to realize that subjective variables are very dependent on circumstances of the parties involved. The policy-maker cannot control plaintiff's expected behavior in the next dispute, and neither can he foresee (or influence) if the party will

[40] At the time Cooter wrote his paper, the rule 68 of the United States Federal Rules of Civil Procedure, which is a copy of the alluded rule from California, was not enacted yet. That rule states as follows (https://www.federalrulesofcivilprocedure.org/frcp/title-viii-provisional-and-final-remedies/rule-68-offer-of-judgment/, access in 14/11/2019):

Rule 68 – Offer of Judgment

(a) *Making an Offer; Judgment on an Accepted Offer*. At least 14 days before the date set for trial, a party defending against a claim may serve on an opposing party an offer to allow judgment on specified terms, with the costs then accrued. If, within 14 days after being served, the opposing party serves written notice accepting the offer, either party may then file the offer and notice of acceptance, plus proof of service. The clerk must then enter judgment.

(b) *Unaccepted Offer*. An unaccepted offer is considered withdrawn, but it does not preclude a later offer. Evidence of an unaccepted offer is not admissible except in a proceeding to determine costs.

(c) *Offer After Liability is Determined.* When one party's liability to another has been determined but the extent of liability remains to be determined by further proceedings, the party held liable may make an offer of judgment. It must be served within a reasonable time—but at least 14 days—before the date set for a hearing to determine the extent of liability.

(d) *Paying Costs After an Unaccepted Offer*. If the judgment that the offeree finally obtains is not more favorable than the unaccepted offer, the offeree must pay the costs incurred after the offer was made.

be willing to solve the controversy quickly, if he is risk averse or not. These variables are just some proxies that influence the decision-making process leading to settlement or litigation but can't be used by lawmakers and institutions to design structures applicable to all cases in order to increase settlement rates. Legal institutions, however, can be objectively designed to increase settlement rates. In other words, they can be controlled and designed to achieve a specific public policy goal.

For example, Rule 998 of the California Code of Civil Procedure (or the rule 68 of the United States Rules of Civil Procedure) works as a settlement inductor. Through this rule, if a defendant makes a formal settlement offer to the plaintiff, the plaintiff must pay the cost incurred by the defendant after the offer is made, unless (assuming the case is tried to verdict) the awarded compensation exceeds the amount of the offer[41]. The application of this rule does not depend on personal characteristics of the parties and it can therefore be used in any situation where a settlement offer has been made before (or even during) trial.

Rule of Law is (can also be thought of) a legal institution that influences the decision to settle or litigate. Rule of Law does not have a precise definition, so for this paper we will consider it as the simple idea/rule that emanates from the judicial system through the combined application of statutory law and jurisprudence. In order that the rules of the game be predictable, the rule of law requires a fair and stable Judiciary.

There is already some literature that asserts that a well-defined rule of law can increase settlement rates. Most scholars[42]

[41] One of the authors has presented a draft idea similar to Rule 68 of the USFRCP, to be used in Brazil. For details, see Silva Neto, Orlando. Responsabilidade civil pela perda do tempo útil: tempo é um ativo indenizável. (in English, *Is time spent in pursuit of compensation a indemnifiable asset?)* In. Rodrigues Jr., Otávio (org). Revista de Direito Civil Contemporâneo, N. 2. V. 4, Ju/Sept. 2015, p. 139-162.

[42] Somehow contrary to this "main conception", Dan Foote (1995) showed that when Japan courts started publishing "the rule of thumb" for traffic accidents (which equalized the Rule of Law toward this matter and even increased the potential damages

are already aware and agree with the notion that when the rule of law is well established, reasonably stable and clear[43], parties will know (or are more likely to know) the expected outcome of the controversy and will bargain to a solution close to the one predicted by the rule. However, if the rule of law is not clear, the variance in rules will mean a variance in the likely outcomes, which, when framed by human biases (such as I -plaintiff- will receive more and I – defendant - will pay less: *Overconfidence[44]*), will make the parties more likely to pursue a trial rather than settlement[45].

For example: assume that for a given labor accident type (x) with the same (or very similar) consequences to the injured party courts of the country award compensation for actual loss of income equally but damages related to pain vary from $10.000 to $60.000. In this case, the plaintiff will pursue compensation and damages related to pain in a value close to

recovered by plaintiffs), the number of complaints one year after its publication (1968-1969) spiked from 5,514 to 10,416. An interesting fact is that after this abrupt increase, in 1970, the number of deaths by traffic accidents and complaints filed, which were constantly increasing since 1964, started to decrease. Deaths from traffic accidents dropped from 21,535 in 1970 to approximately 12,000 in 1978 and kept constant until 1983 (where the data of his research ends). On the other hand, the number of complaints, which reached its peak at 11,620 in 1970, dropped every year to its lower level in 1983 with 3,235. In addition, the author of that work still compares this situation to other kinds of civil suits, showing that the decrease in traffic accident litigation was way bigger than any other sphere of civil litigation.

[43] Classical authors that made such claim include Landes (1971) and Posner (1973). Also, for a more specific discussion on the idea that the clearer is the rule of law, the bigger is the rates of settlement, see: Albiston, Catherine (1991). The rule of law and the Litigation Process: The paradox of Losing by Winning. *Berkeley Law Scholarship Repository*. Also, the relative influence of any legal outcome and its dependence to the effective communication of the result and its meaning (Galanter 1983). And the difference in settlement rates when a matter is approached through written judicial opinion or by confidentiality agreements and the dearth of information (Erlanger et al. 1987). A discussion of this idea in Brazil, see Gico Jr. (2014).

[44] See this cognitive bias at: Samson, A. (Ed.)(2017). *The Behavioral Economics Guide 2017 (with an introduction by Cass Sunstein).* Retrieved from: http://www.behavioraleconomics.com. p. 95.

[45] See Bianca Bez Goulart, *Análise econômica do litígio,* Editora Jus Podium, 2019.

$60.000. The defendant will evaluate the amount that he will probably pay related to pain close to $10.000. The farther these amounts are from each other, the lesser the probability of settlement. On the contrary, if jurisprudence was well established and uniform, stating a rule like, "the plaintiff will receive 3x the value of the actual injury" or "high pain is equal to $60.000", both parties would be aware of the probable outcome and would settle for a value close or equal to the value of the court ordered decision[46] (all other relevant variables equal). This is an idea most scholars agree with and is sort of a fundamental pillar of economic analysis of litigation.

This paper intends to analyze the question from a different perspective. We bring two concrete examples of how the rule of law should be molded to increase ADR rates. These examples are valid for both Common and Civil law.

First, there are interventions that can be done through statutory law, reducing judicial discretion. Statutory law should avoid general clauses or gaps which the judge can fill out according to his discretion. The role of the judge in litigation should only be to consider the facts and circumstances and apply the law, not create the law. Even questions about burden of proof shouldn't be defined by judges, but by statute. If that is not the case, settlement rates will be low.

To illustrate the concept, let's examine the differences between the application of law regarding drug possession in the state of New York and Brazil.

As per article 42 of the Brazilian federal antidrug law n. 11.343/2006[47], the punishment for drug possession depends of various factors mentioned in article 59 of the Brazilian penal

[46] Assuming there are no more attractive alternatives for the defendant – like using his money in an investment that will bring better results than the interest to be paid in case of a court judgement.

[47] BRASIL. LEI Nº 11.343, DE 23 DE AGOSTO DE 2006. Retrieved from:< http://www.planalto.gov.br/ccivil_03/_ato2004-2006/2006/lei/l11343.htm>

code[48], as well as others, such as the quantity of drugs seized and the type of drug. The problem of using these factors is that they do not objectively specify the proportion of punishment regarding the quantity of drugs or which drugs are more "harmful" than others. The consequence is discretionary sentencing by judges. For example, one judge can find that 10 grams of some drug (x) is a relevant amount and profer a harsh sentence. Another judge can decide that this same quantity is insignificant and conclude that the possession by the offender is not a serious criminal offense, therefore disqualifying the conduct to possession for one's own use, a much lesser offense.

Now let´s look at the NY penal code[49], section 220 and on. The Code states punishment for possession of drugs is based in seven degrees of quantity and type of drugs. Differently from the Brazilian criminal law, the NY penal code reduces judge's discretion to determine the punishment depending on the quantity and type of drugs. These two different laws create different incentives. In Brazil, both defendant and prosecution have more incentives to appeal because of the likelihood that there will be a precedent in favor of both parties in dispute. In New York, there is less uncertainty and, in consequence, more of an incentive to engage into settlement.

On the other hand, the behavior of judges and courts also influence the formation of the rule of Law and impact settlement rates. Courts with the highest hierarchy should define leading cases for each matter of law, decisions that should be followed by lower courts (the 'stare decisis' conception[50]). These decisions have to be followed by these primary courts and judges (precedent should always be acknowledged in the judgement,

[48] BRASIL. DECRETO-LEI No 2.848, DE 7 DE DEZEMBRO DE 1940. Retrieved from:< http://www.planalto.gov.br/ccivil_03/decreto-lei/del2848compilado.htm>

[49] STATE OF NEW YORK. New York Consolidated Laws, Penal Law – PEN. Retrieved from:< http://ypdcrime.com/penal.law/article220.htm>

[50] See a critical discussion over the stare decision at: Collier, Charles (1988). Precedent and Legal Authority: A Critical History. *UF Law School Repository*.

even if the judge concludes, for any reason, differently to the precedent established by the higher court).

The observance of precedent is one of the factors that have made common law systems more predictable than civil law systems. Willian Tetley[51] affirms that one of the main differences is that decisions in common law are generally based on judgements of the superior courts while the decisions in civil law systems are mainly based in doctrinal appointments. Based on that, the common law system developed to be more secure and predictable (giving parties incentives to settle instead of litigating) than the civil law system. This happens because when civil law systems base its judgments in doctrine, any decision can be justified. Judges can simply pick and choose the commentator they like best.

One possible solution to curb court discretion is a return to legal positivism.[52] Positivism is somewhat opposed and incompatible with mainstream movements like neo-constitutionalism, widely accepted and applied in Europe and Latin America[53], but it is also different from legal realism and from the economic approach chiefly applied in United States[54].

Legal positivism could work alongside legal realism and the economic approach to boost ADR because these approaches will lead to predictable decisions. Judges will have very little discretionary power and judgment outcomes will be foreseeable. This predictability also increases the likelihood of settlement in the Judiciary, but has an even bigger effect in ADR. If the outcomes are more predictable, why not get there using the

[51] Tetley, William (2000). Mixed Jurisdictions: Common Law v. Civil Law (Codified and Uncodified). *Louisiana Law Review*. Volume 60. Number 3.

[52] See: H. L. A. Hart, (1958). Positivism and the Separation of Law and Morals. *71 Harvard Law Review 593, 601-2*.

[53] See: Tim, Luciano (2014). *Direito e Economia no Brasil*. Atlas. 2 ed. p. 7.

[54] See: William M. Landes & Richard A. Posner (1992). The Influence of Economics on Law: A Quantitative Study. *Chicago Unbound*. An also: Kendall, Keith (2011). The Use of Economic Analysis in Court Judgments: A Comparison between the United States, Australia and New Zealand. *Pacific Basin Law Journal, 28(2).*

alternatives that present better cost-benefit?

However, legal positivism, when twisted by the neo-constitutionalism approach (as it happens in Brazil), would probably decrease ADR and settlement rates. This would happen because the tools which judges use when they apply the law under a neo-constitutionalism view are open concepts, like human rights[55], social function (of contract; of property), ethics and moral, which, in fact, are hugely vague and allow for great variance of decisions from judge to judge, court to court, etc (discretionary).

Based on the above, it is easy to conclude that socially (in terms of net benefits to society) we have the following scale of combinations: 1) ADR + stable/predictable rules; 2) Judiciary + stable/predictable rules; 3) ADR under uncertain/unpredictable rules; and 4) Judiciary under uncertain/unpredictable rules.

Finally, but not less important, the importance of precedent, legal certainty and stability can also be perceived through the lens of economics, specifically when the classic "economic model of litigation" is applied to concrete situations.

The "economic model of litigation" (considering now the rule of law as a variable) highlights the importance of ADR when one correctly understands the equation below[56]:

$$R = [D + P(D)]$$

$$Va = (1-(1/da)).R - [Ca + (pa.da)]$$

$$Vb = (1/db).R + [Cb + (pb.db)]$$

In the formula, "R" represents the rule of law (statutory and jurisprudence prescription). "D" represents the value of the 'monetarily quantifiable' damages suffered by the plaintiff from

[55] Tim, Luciano (2014). *op cit*. p. 8.

[56] This mathematic model is an adaptation of the classical model of litigation. See the classical model at: Spurr, Stephen (2010). *Economic Foundations of the Law*. 2. ed. Routledge. p. 174-175.

the defendant's act. "P" is the proportion of the court amount regarding to the concrete damages that the defendant caused towards the plaintiff (not always applicable, because sometimes these damages are not related to monetarily quantifiable damages). "P(D)" is the value given by the court to the plaintiff as financial compensation for non-promptly measurable damages, such as punitive damages, pain and suffering damages, etc.

"*Va*" represents the expected amount that the plaintiff thinks he will recover from the dispute. "*Vb*" is the expected amount that the defendant thinks he will pay for the plaintiff. "*da*" and "*db*" ("*dx*") represent the amount of discovery that the parties are willing to pursue relative to expected recovery or payment, a value higher than 1. "*pa"* and "*pd"* ("*px*") represent the costs with discovery, which are specific to each case but presumably cheaper for the party acting in good faith (because it will be easier for her to raise evidences in her favor). And, finally, "*Cx*" (a or b) represents attorney expenses occurred on trial.

Notice that "*Cx*" and "*pxdx*" are all transaction costs incurred by parties to solve this dispute through litigation, which could be mitigated through settlement. Notice also that settlement (S) will occur when $Va \leq S \leq Vb$[57].

Thus, if the rule of law is not well defined and, for example, *Va*= $10.000,00; *da = 2* , and *Vb* thinks R = $5.000,00; *db = 2,* even though both parties think their probability of winning/losing are the same, *dx* = 2, which breaks the effect of overconfidence and help the parties to settle[58], and even though expenses with discovery and attorney fees also create incentives to

[57] Consider that if plaintiff expects to recover at least 100 and defendant expects to pay at most 200, then there´ll be a settlement (provided that defendant has resources for paying the settlement) range between 100 and 200. If plaintiff expects to recover 100 but defendant expects to pay only 50, there´ll be no settlement.

[58] This happens because people are generally risk averse, and since there is already an established rule of law, the parties will know who is liable (different than the court that needs to discover that), and then will tend to settle.

settle, the parties will litigate this case to the end rather than reach a settlement, because Plaintiff *Va* will accept values equal or bigger than $5.000,00 (VA ≤ 5000) and defendant *Vb* will settle only when the amount of the bid is equal or smaller than $2.500,00.

When the costs of litigation are high, the probability of settlement will be higher (tend to one[59]). When transaction costs to litigate are low, the probability of settlement will be lower (tend to zero). The same is true when the rule of law is stable and predictable. The probability of parties to settle will tend to one under a clear and stable rule of law. When the rule of law is not clear, the probability of an agreement will tend to zero. This can be expressed as follows[60]:

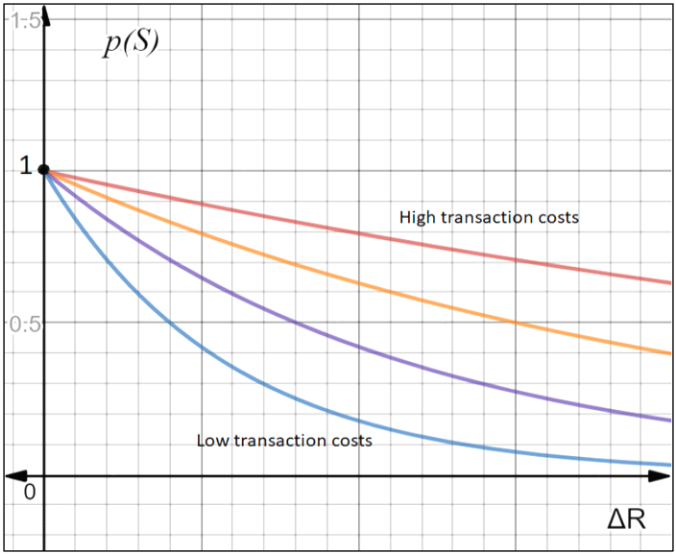

Figure 1 - Probability of Settlement versus Rule of Law

[59] We assume for purposes of this simple model that both parties will incur in the same costs. If costs are different, then the likelihood of settlement will be affected differently. There may be one party more prone to settlement, while the other may refrain from it.

[60] In the graph, 1 means something that will certainly happen and zero means something that will certainly not happen.

CONCLUSION

We showed that the use of ADR benefits not only the parties to the dispute, but also that ADR makes society economically and socially better-off than the use of the judicial system. This happens because ADR allows for more productive ways to allocate time and resources, consequently causing the enhancement of economic growth and society´s quality of life. In the second part, we explained that the use of ADR can be enhanced through a well-defined rule of law.

We demonstrated that the judicial system is a high transaction cost, and the shift from judicial litigation to ADR would enhance economic growth, the creation of new products and society's quality of life. This effect will be even higher under a stable rule of law. To do so, we applied theoretical tests based on a "standard model of litigation" designed by Robert Cooter and showed when – and what makes – settlement more likely to happen.

APPENDIX I

Years of 2006, 2007 and 2009	**100.000 per population**
United States at State level (Civil)	5976.09
United States at Federal level (Civil)	90.32
United States at State level (Family)	1859.22
Total United States	**7925.63**
Japan (Civil)	1773
Japan (Family)	599.84
Total Japan	**2372.84**
France (Civil)	2429.47
France (Family)	671.09
Total France	**3100.56**
Canada (Civil)	1472.79
Canada (Family)	798.3
Total Canada	**2271.09**
England and Wales (Civil)	3401.81
England and Wales (Family)	487.28
Total England and Wales	**3889.09**
Brazil at State level (Civil and Family)	7242.17
Brazil at Labor law level	1488.32
Brazil at Federal level (Civil)	1244.07
Total Brazil	**9974.56**

Rates of litigation per country (Civil and Family cases commenced in a year)

Data from United States retrieved from Statistical Abstract of United States (2009) and National Center for State Courts (2016).

Data from Japan, Canada and France retrieved from Ramseyer and Rasmusen (2010).

Data from England and Wales retrieved from Ministry of Justice (2010).

Data from Brazil retrieved from Conselho Nacional da Justiça (2010). Cases considered for State, Labor and Federal level were those new filed finding complaints ("primeira instância"), enforcement of judicial decisions ("título executivo judicial") and enforcement of special contracts ("título executivo extrajudicial").

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