CHAPTER V

AN ANATOMY OF LITIGATION COSTS AND BENEFITS

This chapter focuses the conceptual and computational aspects of the cost-benefit structure of litigation with special emphasis on opportunity cost. The civil procedural approach as well as the economist's approach to litigation costs are analysed in this chapter.

The scrutinisation and analysis of the true cost burden associated with litigation is important for analysing the micro economics of litigation. There exist several kinds of costs, and one should be very careful about what cost to be used and for what purpose. This study is based on the assumption that for any evaluation regarding net benefits from litigation, one should include the direct, indirect, hidden, and opportunity cost of litigation.

Private costs of litigation refer to that part of total cost which the litigant is to meet. Private benefit is defined as that economic benefit which is enjoyed by the litigant from the litigation. Private cost is usually defined
in opportunity cost terms as the highest valued or most preferred option foregone. Every choice entails a sacrifice. There is always an option 'necessarily forgone' Hence every choice entails some cost—the opportunity cost. 

State is rendering social cost for maintaining judicial infrastructure. These costs include the costs for the construction and maintenance of court buildings, the salaries of judges and other officials etc. Since the present study is confined only to the economic evaluation of micro costs and benefits associated with litigations, public expenditure for administration of justice is set aside.

The objective of private cost-benefit considerations to a litigant is to assess the amount of money by adding up the costs and benefits of alternative economic choices and selecting the alternative which offers the highest net benefit. Resources of a litigant are being used most

efficiently when the benefits over costs are at a maximum. The decision to litigate affects the resource position of a litigant; seeks to maximise benefit relative to costs of resources used in litigation.

A decision to litigate involves choice among alternative courses of action. To make a rational choice, the litigant must evaluate each alternative and determine what it will contribute towards the attainment of the objective of maximization of benefit.

Generally cost of a resource is to be thought of as representing the value of the most attractive alternative use to which it could be put. When a consumer buys a car, for example, the cost he incurs is essentially that some part of his wealth in exchange for the car. Once he surrenders his wealth, he will not be able to use it for any other purpose. The presumption is that the decision to buy the car implies that the consumer puts a higher premium upon car than upon any other bundle of goods and services he could buy with the same amount of wealth. The 'cost' of buying a car is given by the opportunities that one there by forgoes. Similarly 'cost' of
taking a job will be the loss of leisure, time and energy that one could otherwise have used in enjoyable pursuits or in some of the job open to one. So also when a litigant enters into litigation the cost he incurs is that he will have to forgo some part of his total savings or otherwise which he will not be able to use for any other purpose. The assumption is that the decision to litigate in the private property implies that the litigant puts a higher premium upon the litigation than upon any other things and services he could buy with the same amount of savings. A litigant intending to litigate in the private immovable property disputes has several alternatives for using his limited savings. He can use it for buying a government security which will yield profit in the future. He can deposit the money in a bank or can use the money for some productive business enterprise. In spite of these alternatives, he is taking the decision to litigate. Hence, the cost of the litigation will be the loss of money, time and energy that the litigant could otherwise have used in some other productive pursuits or in some other investment open to him. When he is taking the decision to litigate, he expects benefits. Being rational he calculates the different types of benefits in monetary terms. He expects real economic benefits
from litigation. Whether he has acquired, real economic benefit or not is to be determined by evaluating the real costs he incurred for the litigation. Hence he must be aware of the real costs involved in litigation\(^2\).

For estimating the real economic cost of litigation the opportunity cost of litigation should also be included. The cost of having one's wealth tied up in the form of pursuing with a litigation is that the litigant is missing the opportunity of holding the same volume of savings in forms of other assets. In order to estimate the net economic benefit from litigation, the next best alternative forgone for litigation is to be taken into consideration. The litigant has however, the three following important choices.

1. Avoid litigation and use the money for some productive purposes.
2. Make an out of court settlement and
3. Enter into litigation.

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The choice that the litigant makes between these alternatives will reflect among other things, the individual's inclination to accumulate assets, the attitude of the opposite party in the litigation and the risk bearing nature of the litigant etc.  

Nature of Cost-consciousness in Litigation

From an economist's point of view decision about litigation can be approached from the apparatus applied to decision-making under uncertainty. There are two categories of risk - one the probability of which can be calculated and be insured against, and the other probability of which cannot be calculated so that it cannot be insured against. Though the probable loss from litigation can be calculated, at present there is no provision of insurance for covering the risk involved in litigation. For knowing the nature of cost-consciousness in litigation and to evaluate the trend in the cost-incurrence, litigants in Kerala have been classified

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in three categories 4.

I. Risk Averter

Risk Averters are those litigants who are reluctant to take risk and always prefers to out of court settlement for the redressal of their grievances. As per the cost-benefit position of litigation scenarios stated in the Model, risk avertors are assumed generally to be in the $\text{tb} > \text{tc}$ position. In this position total benefit from the litigation is greater than total cost and so seeking the procedural justice is desirable. Greater the difference, greater will be the desirability.

II. Risk Neutral

Risk neutral litigants are those litigants who accept only fair litigation and avoid unfair litigation. As per the analysis of the Model the final cost-benefit position of the risk neutral is assumed as $\text{tb} = \text{tc}$.

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4 This Classification is made in the model which is explained in Chapter IV.
II. Risk Taker

Risk takers prefer to take risk for getting maximum benefit from litigation. They even expect unfair prospects from litigation. The Model developed for the study assumes that they are by and large in the \( tb < tc \) position.

The different behaviour of litigants under conditions of uncertainty reveals that costs of litigation are not known to litigants in advance. Under conditions of uncertainty litigants find it difficult to choose that course of action which is most beneficial to them. In such a context consumers or legal services could not be assumed to maximise economic benefit. However, the above mentioned classification of litigants is based on the nature of litigants under conditions of uncertainty\(^5\).

The classification of litigants as risk averters, risk neutrals and risk takers is made for analysing the

behaviour of litigants in the four districts of Kerala. The changes in the behaviour of litigants after having proper cost consciousness throw light upon the fact that real cost awareness plays a key role in the decision to litigate.

Economic Evaluation of Litigation Costs

The litigation costs can be analysed at two levels. First, the Civil Procedural Approach to litigation costs, i.e., costs as per section 195 of the Civil Rules of Practice in Kerala. In this approach litigants are considering only the direct cost. Second, the economist's approach to litigation cost where the true litigation costs are estimated.

For the estimation of total economic cost both explicit and implicit costs should be estimated, for which, both accounting cost and opportunity cost are to be analysed and determined. The economic cost in a litigation can be estimated by analysing the structure of direct, indirect, hidden and opportunity cost of litigation.
Structure of Direct Cost

The structure of direct cost is included in the Civil Rules of Practice in Kerala which is shown in Appendix I.

1. Structure of Indirect Cost

The different items that can be included under indirect costs are listed as follows:

1. Travelling expenses
2. Dearness allowance
3. Wages or salary to the labourers employed in litigation
4. Rate of interest, if the money is borrowed.
5. The expenses incurred for executing the decree.

Structure of Hidden Cost

The hidden costs that are involved in litigation are the following:

1. Financial loss due to the mental agony resulting from the suit.
2. Financial loss due to negative impact of litigation on occupation of the litigation.

3. Expenses incurred for the criminal offenses consequent on the civil suit.

Structure of Opportunity Costs

The various ways by which the opportunity cost of litigation may be emerged are listed below:

1. The normal alternative returns from the money expended on litigation.

2. The earnings that could have been made by the alternative employment of litigants managerial ability.

3. Normal return that could have obtained from disputed property

4. Reasonable return on the money borrowed for litigation, if invested outside.

5. Difference between the real interest rate and interest rate fixed by courts.

6. Money rewards for factors owned by litigant and employed in litigation including time.
When a litigant decides to litigate he has to pay prices for the factors which he employed in his litigation. He thus incurs direct, indirect, hidden and opportunity costs. An accountant will consider only the payment and charges made by litigant to suppliers of various legal services. But an economist's view of cost is somewhat different from this. The litigant spends certain amount of money for his litigation. If that money were invested elsewhere it might have earned certain amount of interest or dividends. Moreover, a litigant devotes time to his litigation, and contributes managerial ability to it. If he had not entered into his litigation he could have utilised his managerial ability and time for some other productive purpose. The economist would therefore include in his cost of litigation (1) the normal return on money rendered by litigant on litigation which he could have earned if invested outside, and (2) the wages or salary he could have earned if he had utilised his services to some other productive purpose. The economist take into consideration all types of cost incurred for litigation. In order to determine the net benefit from litigation, both the explicit and implicit litigation cost should be estimated. However, an ordinary litigant is
considering only the Civil Procedural Approach to litigation costs where he is estimating only direct costs. But a litigant should take into consideration not only direct cost but also the other different components of litigation costs.

**ECONOMIST'S APPROACH TO LITIGATION COSTS**

Litigants are usually motivated by plain common sense regarding cost-benefit in litigations. Decision-making behaviour of litigants are not generally based on any rational analysis. However, a litigant who is assumed to be rational should have economic reasoning. Economic approach to litigation can help in taking practical litigation decisions. For example, a litigant intends to enter into a civil suit related to an immovable property worth one lakh rupee. This party has a definite option for an out of court settlement sacrificing ten thousand rupees. If the litigant is a 'risk-taker' he may consider for the litigation in anticipation of maximum economic benefit. Sometimes his advocate also may favour for the litigation. However, he has to spend an average period of four years for the first decision. If the first decision is not in his favour he has
to spend again four years for the decision from the appeal. The total economic costs for the litigation may amount to approximately Rs. 25000/-. The result of the decision cannot be predicted as there is uncertainty. If the party is seeking the advise from an economist, he may advise not to proceed with the suit. Mere commonsense can be frequently misleading. A single economic concept, opportunity cost, helped the economist to form a rational advice. If Mr. X is making an out of court settlement by sacrificing Rs. 10000/-, he will be able to utilise the remaining Rs. 90000/- in several economically beneficial alternatives. If he is taking a decision to litigate he will be able to obtain only one lakh rupees. In this position he is not able to enjoy more economic benefits than the economic benefits from the out of court settlement.

Economic reasoning explains why and when a decision regarding litigation is to be taken. A litigant, who is assumed to be rational should be able to construct an arithmetical hypothesis which could increase his benefits or reduce his losses. Certain key concepts are very powerful for drawing rational conclusion from the problems related to the
decision to litigate. A number of concepts that meet these criteria are listed below. The list is based on the literature on economic analysis of law.

1. Opportunity cost
2. Rational consumer
3. Utility maximisation
5. Financial objectives-interrelationship among long and short-run profits
6. Present value and discounted cash flow
7. Private cost-benefit analysis.

The utility maximisation behaviour of litigants could be analysed with the help of the above mentioned concepts in the economic analysis of legal issues. The analysis which could be made through different theoretical expositions may draw light upon the various ways by which a litigant could maximise his net benefit from litigation.

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Rational Decision-making in Litigation

The rational approach to decision-making in litigation includes the following elements.

a. Identification of the economic objectives involved in the civil dispute.

b. Identification of the opportunity cost in the litigation.

c. Structuring of what one knows about the phenomenon involved in the decision under consideration - model building

d. Identification of alternative actions available.

e. Identification of the effects of each attractive alternatives.

f. Evaluation of the most attractive alternatives.

g. Selection among the different alternatives.

Before deciding to litigate a litigant has to consider these elements. Still, circumstances may not permit a litigant to devote the time and resources required to

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perform each step, and he will be forced to pick out those on
which to concentrate his attention. A consumer of legal
services seeking to maximise his benefit and assumed to be
rational must consider these ideal elements for benefit
maximisation. In the operational place how far an average
consumer of legal services in Kerala departs from these
normative decision-making elements have been investigated and
analysed with the help of primary data. Modeling the micro
economic effect of litigation developed for the study serves
as an intellectual tool for the analysis.

Though all decisions have some economic ingredient, litigants make two types of decisions that are fundamentally
economic in character. The first type can be termed 'comprehensive' decisions. Comprehensive decisions require
the litigant to select combinations of actions out of a huge
number of possibilities and to determine how far to pursue
each of them. The second type of decision can be termed 'single'. This decision is usually caused by an unexpected
occurrence of a dispute. Here the litigant deals with a single decision.
The comprehensive and single decisions in litigations follow the economic goal of 'optimum allocation of resources'. It means that the decision maker or the litigant use the resources where he get the most economic benefit. The nature of resource allocation as well as the basic logic involved in approaching both comprehensive and single decision can be examined in an ideal theoretical plane. The decision-making behaviour of litigants in Kerala can be examined with the help of the theoretical classification such as Risk avertors, Risk neutrals and Risk takers. Resources are being used most efficiently when the excess of net benefit over cost is at a maximum. Efficient resource use requires a clear identification of economic goals, knowledge of what resources are available, and knowledge of how those resources can best be used to produce what is desired. In other words litigants seek maximum net economic benefit relative to economic cost.

The economic logic underlying comprehensive decisions are equimarginal principle and micro cost-benefit analysis. The equi-marginal principle can be applied to allocated resources of litigants efficiently. This principle
incorporates a rationale that explains how to get maximum output from the use of any particular quantity of resources. The theory states that when marginal utilities have been equalised through the process of substitution one get maximum satisfaction. Though the present study pinpoints only the quantitatively measurable monetary benefits, the equi-marginal analysis helps to know the ideal theoretical method of decision-making of litigants. The essence of micro cost benefit analysis is that the 'worth' of any action, project, investment strategy equals the excess of the benefits it yields over the costs it entails. To pick out the best of the alternatives available, a litigant should estimate the net benefits to be obtained from each, and pick out the one offering the greatest net benefits.

The issues to be resolved in any litigation decision are as follows:-

1. What effects of the litigation should be included in its cost and what effects represent benefits?

Benefits occur when one gains an objective: costs are occurred when on loses an objective
An informed litigant should include only economic costs and benefits that result from the decision to litigate.

2. How can a litigant deal with the uncertainty of the effects of each alternative action?

The different outcomes from the alternative actions should be identified explicitly, in particular the amount of benefits and costs that might cause to the litigant.

3. How can a litigant value the effects of litigation especially in its intangible effects?

The situation consists of getting a thorough understanding of the problem under investigation, and that requires the use of the model.

4. How can a litigant take into account the fact that the effect of litigation occur at different points of time?

This problem has a relatively simple solution: it is to state all effects at present values.
5. How can a litigant consider the costs involved for the mobilisation of the money for litigation expenses.

The costs involved for the collection of litigation expenses should be identified and it should reckoned in the total cost of litigation. While identifying the opportunity cost of the litigation, the litigant has to consider the important alternative, making an out of court settlement, and thus avoiding the trail. If he is making an out of court settlement he will be able to dispose his property, and the money obtained by selling the property can be invested in various profitable enterprises. If he is not considering this alternative he is missing the opportunity of making rational profit expectation from the property.

The objective of maximum net gain may be linked to the objective of optimum allocation of litigant's resources. If a litigant makes a decision that yields a maximum of net benefits, he will be using his resources efficiently. A litigant will find occasion to apply the equimarginal principle to litigation decision within the broad framework of micro cost-benefit analysis.
Constraints on the Litigant

A litigant chooses freely among all theoretically possible alternatives. The important limitations of the litigant related to the decision to litigate are the following:
1. Lack of financial resource to carry out the litigation.
2. Uncertainty involved in the decision.
3. Opportunity cost consideration of the litigation.
4. Delay involved in getting the decree.
5. Delay involved in executing the decree.

In spite of the above-mentioned limitations, a litigant must count the micro costs, and should be realistic about the probability of attaining net economic benefit.

OPPORTUNITY COST AND LITIGATION

The present study considers only those benefits which are quantifiable in terms of money. In order to evaluate benefits from an economic point of view, opportunity cost also should be estimated in total economic costs.
The concept of opportunity cost is one of the most central of all economic ideas. Opportunity cost has different applications but our goal to discuss opportunity cost in the computation of total cost of litigation. The concept of opportunity cost rests on the fact that to do certain things, one must forgo the opportunity to do other things. The limited resources of litigants prevent them from doing everything they wish to do. Their choice in any situation thus may force them to sacrifice something of value what they could gain by exploiting some alternative. Limited resources thus are the source of opportunity cost; litigants incur no opportunity cost when they possess unlimited resources. Opportunity cost arises only when litigants must forgo opportunities they would like to exploit. The managerial ability that a litigant may render for conducting the litigation may be of limited alternative but the money expended for the litigation have several alternatives. The total cost of litigation rendered by a litigant could have been invested elsewhere and the litigant should have earned a positive amount of money. The cost in these situation does not involve any actual outlay of funds or a reduction in the value of assets but rather the giving up of what the litigant
could have attained.

The concept of opportunity costs serve a litigant in two main ways. First, it helps to identify cost-creating actions and decisions that might otherwise be ignored. More specifically, it directs attention to certain costs that are not usually recognized, and are not recorded in the regular books of account. Second, it guides a litigant to the proper measurement of costs that are not accurately reported in the regular accounting records. Opportunity cost concept is thus valuable mainly because of the fact that accounting records either omit certain costs or measure them inaccurately.

In the operational plane a litigant does not include in his accounting records valuation of things that he did not do—his forgone opportunities—and he is not in a position to obtain such accounts. But forgone opportunities should be properly valued for the estimation of real economic cost. Thus one cannot evaluate a decision to litigate simply by examining its economic benefit; one must consider the alternative actions that might have been taken instead. To apply the opportunity cost concept in this manner a litigant
is expected to turn up the most attractive, feasible alternatives and select the most attractive among them. The concept of opportunity cost does not explain how to search for attractive alternatives and does not help one decide when one has searched long enough for attractive alternatives. It does, however, require a litigant to be explicit about the alternatives that were considered and to place a value on them.

Apart from forgone opportunities, certain other costs sometimes are not recorded in litigant's regular books of account. These are the costs for the use of the litigant's time, the cost of the factors owned by litigant and employed in litigation. Often, the litigant conducting his own litigation is paid no salary. But the concept of he opportunity costs instructs, these people sometimes give up the opportunity to take gainful employment with others in order to serve their own litigation; what they could have earned then represents a cost of working for themselves. Similarly, if he spends money in his own litigation that would have been invested elsewhere to produce a return, he could also incur a cost. To ignore these costs is to exaggerate the economic benefit from the litigation.
When a litigant invest certain amount of money in his litigation, he usually ignores the benefits he would have realised from the things he would have done if he had not entered into the litigation. The concept of opportunity cost thus enjoys litigant to be practically alert for the 'hidden cost' of resources that are usually not associated with either money outlays or accounting cost.

The concept of opportunity cost stress that the true cost may not be of what the litigant has spent in his litigation or is currently paying, for the litigation. The true cost to the litigant is what he actually gave up, i.e., what he would have gained from putting that litigation cost to its next best use. Another aspect of opportunity cost is that the litigant should give explicit attention to the future alternatives he may give up by making a particular commitments in the present.

In short, the important concept of opportunity cost holds that any action forcloses other actions when one has limited resources. A wise decision-maker in litigation will
search out alternatives consciously. He has to consider the following alternatives known to him.

1. Pick out the best of those alternatives known to him.
2. Include as costs the value of resources used to carry out a decision, even though no payments or accounting charges were made for them.
3. Value resources already possessed or employed by what they could produce for the litigant in alternative activities rather than by what they cost originally or are paid currently.
4. Identify and place a value on future opportunities whenever they are about to commit sizeable amounts of resources.

THE ECONOMIC BENEFITS FROM LITIGATION

To litigate means to carry on a legal contest by judicial process. Litigation costs represent only one side of litigation; the other side of it is benefits from litigation.

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Evaluation of benefits from litigation is a complex affair. Some benefits produced from litigation might be personal whereas others might be economic. Some benefits might be of a short-run character while other might have lasting implications. Personal benefits might be legal, and it might be non-monetary in character. Before evaluating benefits from litigations, one must be aware of the structure of benefits from litigation. In view of this multiplicity of dimensions, the solution adopted in this study is to divide the benefits from litigation into two categories: those benefits that are more or less quantifiable, and the others. The magnitude of the former could be assessed and the non-monetary aspects of benefits from litigation could not be assessed. The quantifiable benefit should have to be in terms of money. Since the study is confined to the economic evaluation of litigation, the non-quantifiable aspects of litigation benefits are disregarded.

**Structure of Benefits from Litigation**

For the purpose of analysis, the structure of benefits could be discussed as follows:
1. Decree from Courts

There will be direct economic benefit through decree obtained from courts. Decrees may be with costs or without costs. After the execution of decree, litigant might be in a position to enjoy economic benefits.

2. Capital appreciation

There are prospects of capital appreciation from private immovable property. The increasing trend in the value of private immovable property might be beneficial to litigants.

3. Invisible Economic Benefits

There might be occasions where economic benefits could be obtained to litigants from the proper enforcement of their civil rights. If the civil rights of litigants are enforced, they might be able to attain the mental make up for accruing prospective economic benefits.
4. **Indirect Economic Benefits**

If a decree is obtained in favour of a party, he could be able to enjoy future economic benefit from his property. The value of the property could be used for attaining economic benefits. For example, the property could be pledged for getting economic benefit.

5. **Immediate Economic Benefit**

If a party is reluctant towards litigation, the opposite party will correctly guess this position, and will try to exploit it. Prospective economic loss could be avoided from the decision taken for litigation.

An anatomy of litigation costs and benefits is useful for knowing the conceptual and computational aspects of litigation cost with special emphasis on opportunity cost. In the process of cost-benefit scrutiny the hither to unrecognised economic costs can be realized. The depiction of the broad spectrum of benefit structure will also help to determine the net economic benefit from litigation. It is clear that a litigant must evaluate each alternative action for the attainment of maximisation of benefits.