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The preventive effects of Hungarian tort law – A simple law and economics analysis**

Introduction

When analysing tort law, it is worth placing more emphasis on the preventive effect than is currently the case in the Hungarian legal literature.[1] It is indisputable that the reparation principle is reflected in many court decisions and a number of tort law rules cannot be understood without it, but if we focus on the reparation principle alone when analysing the aims of tort law, it really leads to the steady decline, and sooner or later disappearance, of civil law liability, to use László Sólyom's expression.[2] Indeed, in recent times, reparation has become increasingly easy to achieve using other techniques (for example with the help of insurance, or no-fault systems[3]).

This is when law and economics comes in, as its models can be used to predict the preventive effect. Here, the basic idea is that the probability of a harmful event (accident[4]) depends on the actions of the (potential) tortfeasor and the (potential) injured party respectively. However, why and how such an effect occurs and how tort law affects precaution is far from clear. (By precaution, we mean all those actions that reduce the likelihood of an accident occurring.)

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1 Bárdos P., *Kárfelelősség a Polgári Törvénykönyv rendszerében,* (HVG-ORAC, Budapest, 2001) 13; Jobbágyi G. and Fazekas J., *Kötelmi jog*, (Szent István Társulat, Budapest, 2004) 144; Fuglinszky Á., Az európai kártérítési jog egyes jogfilozófiai és jogpolitikai alapkérdései, in Paksy M. (ed.), *Európai jog és jogfilozófia: Konferenciatanulmányok az európai integráció ötvenedik évfordulójának ünnepére,* (Szent István Társulat, Budapest, 2008) 203; Szalma J., Gondolatok a kontraktuális és a deliktuális felelősségrol, különös tekintettel az új Ptk. vonatkozó szabályozására, (2014) (51) *ELTE Acta,* 217.

2 Sólyom L., *A polgári jogi felelősség hanyatlása,* (Akadémiai Kiadó, Budapest, 1977).

3 See e.g. K. Fiore, No-fault compensation systems, in F. Michael (ed.), *Tort Law and Economics,* (Edward Elgar, Cheltenham, UK and Northampton, MA, USA, 2009); I. R. McEwin, No-fault Compensation systems, in B. Bouckaert and G. De Geest (eds), *Encyclopedia of Law and Economics, Volume II.* (Civil Law and Economics, Edward Elgar, Cheltenham, 2000) 735–763.

4 Classical economic analyses of tort law also use the word „accident" to refer to the event. See e.g. G. Calabresi, *The Costs of Accidents: A Legal and Economic Analysis*, (Yale University Press, 1970); S. Shavell, *Economic Analysis of Accident Law,* (Harvard Univ. Press, Cambridge, MA, 1987).

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The model of prevention

There are many complex models of the preventive effect in the literature of law and economics, which I will group into two broad categories. One I call cost-based and the other expectation-based incentives.

The idea of a *cost-based incentive* is that the level of the cost associated with the loss and precaution has an impact on the precaution. This cost includes the damages payable on the side of the tortfeasor and the loss to be borne by the injured party in excess of the damages, and these two (also) depend on the legal decision, the jurisprudence. If the personal costs of the parties are (expected to be) higher in the event of the loss, they will do more to avoid the accident – and will take greater precautions. If the tortfeasor bears a larger share of the loss, they are likely to be more precautious. However, in this case, the injured party bears a smaller share of the loss – and therefore their incentive is reduced. This is the so-called compensation paradox: one party's incentives can only be strengthened by weakening the other's.

The *expectation-based incentive* occurs when the tortfeasor can avoid liability by complying with the legal standards. In this case, raising or lowering the standards or expectations has an impact on the level of precaution. Naturally, this system does not encourage precautionary measures that are known to be unprovable in court – and therefore cannot be formulated as a legal standard or expectation in practice.

Basic forms of liability for damages

The two incentive models appear in their pure form in the case of negligence-based liability with a predictable (and not very high) expectation and in the case of strict liability. The tortfeasor would face an expectation-based incentive in the former case and a cost-based incentive in the latter. (In both cases, the injured party would face a cost-based incentive; in the case of negligence, because the potential tortfeasor will almost certainly comply with the expectation and the injured party can be almost certain not to receive any damages or reparation and thus they would have to bear the full cost of the loss).

However, the liability regimes that currently exist in Hungarian law (or in other legal systems) rarely fall into these two clear categories. Considering the two basic forms in the Hungarian system,

1. the fault-based form can be described as comparative negligence, in which legal standards or expectations are not always predictable,

2. liability for hazardous operations is also a kind of comparative negligence system without any predictable expectation – but here the level of legal standards or expectations is very high.

That is why both of the incentive effects are always present. In the case of fault-based form, the precautionary level of the potential tortfeasor is essentially determined by the expectation-based incentive, but the cost-based incentive modifies this level slightly, and the injured party, who is the ultimate bearer of harm,[5] is subject to a cost-based incentive. The situation is reversed in the case of strict liability. The tortfeasor is the ultimate bearer, so the tortfeasor essentially faces cost-based incentives. (Expectation-based incentives are exceptional.) The injured party, on the other hand, primarily chooses their level of precaution in response to the expectation-based incentive, modified only to a lesser extent by the cost-based incentive.

However, before analysing the incentive effects of specific forms of liability in more detail, it is worth considering how precaution is affected by causation and by the assessment of damage; moreover, these issues arise in both forms of liability.

Common elements: the impact of causation on precaution

Causation essentially affects precaution depending on whether it works with a broad or narrow definition of causality. If the courts use a broader definition of causation, the cost-based incentive will be stronger, because it increases the range of consequences for which the tortfeasor is liable to pay damages. In such cases, an essential consideration is whether the case law is willing to apply other principles of causation in addition to the *conditio sine qua non* rule (or but-for test) such as probabilistic causation (or other principles such as testing for a substantial increase in probability), the foreseeability test, or proximate causation.

In expectation-based systems, causation becomes important when courts predictably base their decisions on negligence-based causation. This would mean that causation would only be assessed in relation to the actions of the tortfeasor for which they are otherwise at fault - the damage (or risk of damage) that would have been faced by the tortfeasor even if they had behaved as one would expect would not be considered as having been caused by them.

In the context of causation, the problem of joint causation must also be addressed, where the law makes several parties jointly and severally liable because of the uncertainty of causation (or the difficulty of proving it). Here the incentive effects depend strongly on

(i) the contributions; in other words, how the damages are shared among the joint tortfeasors, for example in a second lawsuit and

[5] C. Robert and U. Thomas, *Law and economics,* (Pearson, Boston, MA, 2011) 212.

(ii) the settlements – what the legal consequences of individual agreements between one of the tortfeasors and the plaintiff are.

Common elements: damages

The key to the concept of loss in law and economics literature is the *willingness to accept* that it is the amount of money that puts the victim on the same level of utility (benefit) (but not the same position!) as they would have been if the damage had not occurred. According to neoclassical normative economics, such a loss should and must only be compensated if it is also an externality;[6] in other words:

(i) if it has not been previously accepted by the injured party, at least implicitly, or

(ii) if there is no presumed offsetting positive effect on any other member of society or the economy.

The concept of loss in law bears some – perhaps unexpected – similarities with this claim of an efficiency-seeking normative economic analysis of law. Such is that the scope of damages to be recovered is narrower than the scope of the costs of disadvantages. At the same time, there are elements that differ sharply; for example, the exclusion of some forms of loss from the legal concept of damages (in particular preferential value).

Similarly, there is a divergence between contemporary Hungarian law on the one hand and law and economics on the other hand concerning the concept of non-pecuniary damage. In the legal literature, it is sometimes argued that the distinction between (pecuniary) damages and grievance award (non-pecuniary damages) is important because a breach of personal rights cannot be compensated as precisely as pecuniary loss, nor can it be measured in money.[7] Law and economics do not see such a difference.[8] For this reason, law and economic theory will not regard the grievance award for non-pecuniary loss as punitive damages (as known in American jurisprudence) as the legal literature sometimes has done.[9] The law and economic analysis stresses that the purpose of this form of damages is the same as the purpose of pecuniary damages – they attempt to compensate for a breach of rights.

[6] This statement is best described in the economic analyses of the Pure Economic Loss. See e.g. G. Dari-Mattiacci and H.-B. Schäfer, The core of pure economic loss, (2007) (27) *International Review of Law and Economics,* 8–28. DOI: https://doi.org/10.1016/j.irle.2007.04.002; J. De Mot, Pure economic loss, in F. Michael (ed.), *Tort Law and Economics,* (Edward Elgar, Cheltenham, UK and Northampton, MA, USA, 2009) 201–214.

[7] See decision of the Constitutional Court No. 34/1992 (VI. 1.) AB.

[8] See e.g. S. D. Lindenbergh and P. P. M. van Kippersluis, Non pecuniary losses, in F. Michael (ed.), *Tort Law and Economics* (Edward Elgar, Cheltenham, UK and Northampton, MA, 2009) 215–227.

[9] See e.g. Fuglinszky Á., *Kártérítési jog,* (HVG-ORAC, Budapest, 2015) 833–837; Faludi G., Gondolatok a kártérítési jogról egy új monográfia kapcsán, (2016) (6) *Jogtudományi Közlöny,* 340.

If we consider the economic and statistical techniques that can be used to estimate the magnitude of the damage, we must conclude that the Hungarian legal practice narrows the scope of the legal issues in an inefficient way and leaves too much room for experts. The exact amount of damages can be estimated by several professional (e.g. economic and statistical) methods. Case law must have a say in deciding whether to use methods that typically result in a higher amount of damages or use those that do the opposite. This is not a mere technical or professional issue – the preventive effects of tort law depend on it.

Types of liability 1: Fault-based liability

The analysis of fault-based liability in Hungarian jurisprudence is not straightforward, because – as stated above, what aspects the court takes into account when assessing the "conduct that can generally be expected in the given situation" is unclear (unlike, say, the Hand rule in the US system, which makes similar decisions more predictable). Partly because of this unpredictability, evidentiary process fundamentally influences the incentives, which has several Hungarian specificities.

First, the reverse burden of proof is the general rule in Hungarian tort law. On the face of it, this should encourage the tortfeasor to take more precautions, but this is only true if it is unlikely that the tortfeasor would be found negligent under the normal burden of proof. (If negligence is more likely to be established by the court under the normal rule then reversing the burden of proof may sometimes even reduce the precautionary incentives.)

Second, hindsight bias appears in many rulings. The courts often determine legal standards or expectations ex post, in the light of the actual loss suffered by the victim. The same act or conduct is more likely to be attributable to the tortfeasor if, of the potential losses, the greater one actually occurs, and the risk of this "bias" can, under certain conditions, increase the precautionary incentive.

Types of liability 2: liability for hazardous operations

In Hungary, it is up to the case law to define the range of activities that fall under the scope of "hazardous operations". The prevention-based approach of law and economics can help in that. Because, as we have seen, the two systems create different incentives, the question is when the different incentive-prevention effects should be applied?

Although the preventive effects of the two forms of liability differ, it does not follow that strict liability always encourages the tortfeasor to take greater precautions. It will only do so if the expectation in the event of negligence would be too low, for

example because of unobservable, unprovable actions. If the legal standards or expectations are high, the incentive effect will be reduced by a shift to strict liability – especially if the amount of damages (e.g. due to assessment problems) is lower than the actual loss.

It is well-known from the law and economics literature that, in the case of a shift to strict liability level of activity will decrease. (Using Richard Posner's example: "One way to avoid a highway accident is to drive more carefully, but another is to drive less."[10] The second is the activity level. Likewise, the level of activity is the amount of goods or services produced by a plant, the number of jobs undertaken by a trucking company or the amount of waste stored in a landfill – using a given safety technology etc. This raises the question of when should the decline of the activity be an aim? Efficiency-based normative economics models stress that this is related to whether there is an alternative activity towards which it is worth "diverting".)

The literature often stresses that the shift affects the appetite for litigation.[11] At first glance, it may seem that the shift induces more lawsuits because this change increases the chances for the plaintiffs to prevail. However, the eventuality of a settlement between the parties should be taken into account as well. As stricter liability makes the rulings more predictable, the difference between the expectations of the parties reduces, so the chances of a settlement will also be higher.

Types of liability 3: vicarious liability

There are several forms of vicarious liability in Hungarian tort law. In some cases, the direct and indirect tortfeasors are jointly and severally liable, while in other cases (e.g. if the loss is caused by an employee) only the indirect tortfeasor can be sued. Sometimes the indirect tortfeasor has strict liability, while in other cases their conduct is taken into account their negligence is assessed). There are cases when the indirect tortfeasor can ask the direct tortfeasor to pay the contribution; and there are cases when they cannot or can only partially do so. Of course, different forms also create different incentives for the direct tortfeasor, the indirect tortfeasor and the injured party.

Moreover, as many out-of-tort-law elements affect the incentives, it is even more difficult to assess the preventive effects. For example, the content of the contracts between the parties, or many non-legal elements of their relationship, influence whether and how the indirect tortfeasor can take action against the direct tortfeasor before or after the accident.

[10] See e.g. R. A. Posner, *Economic Analysis of Law,* (8th edition, Aspen Law and Business, New York, 2011) 226.

[11] S. Shavell, *Foundations of Economic Analysis of Law,* (Belknap Press, Cambridge, MA, 2004) 280–287. DOI: https://doi.org/10.4159/9780674043497

Types of liability 4: quasi-contractual liabilities

The Hungarian Civil Code distinguishes between tortious and contractual liability. It is more difficult to be exempted from contractual liability but there are cases where the rules of tortious liability must be applied and the parties cannot (even by common consent) derogate from them. They cannot exclude or limit liability. Such "grey zone" forms are product liability and the liability of healthcare providers to their patients.

The distinguishing feature of these quasi-contractual situations is that the price of the product or service may increase due to the non-excludable, non-restrictive liability. Because of these obstacles, the injured party cannot decide whether they are willing to accept more risk in exchange for a lower price.

According to normative economics, the main argument in favour of the application of such a mandatory liability rule is information asymmetry, or the problems of bounded rationality.[12] In the two main areas (product liability and malpractice cases), these arguments seem valid. However, it is questionable whether mandatory rules (as a form of hard paternalism) are necessary or soft methods (nudging, sticky default rules) would be enough. Under soft paternalism,[13] liability would remain within the contractual forms.

Conclusions

The law and economics models of prevention of help to identify the factors that determine the strength of the preventive effect of tort law. It is obvious that simply switching from one form of liability to another will not necessarily strengthen the incentive. Similarly, it is not true either that raising the amount of damages, establishing causality in a simpler way or making the burden of proof easier for the plaintiff would strengthen the initiatives of the potential tortfeasors in any case and would lower those of the potential injured parties. The models help to identify those factors under which

[12] See e.g. D. Kahneman and A. Tversky, On the Psychology of Prediction, (1973) (80) *Psychological Review,* 237–250. DOI: https://doi.org/10.1037/h0034747; A. Tversky and D. Kahneman, Judgment under Uncertainty: Heuristics and Biases: Biases in judgments reveal some heuristics of thinking under uncertainty, (1974) (185) *Science,* 1124–1131. DOI: https://doi.org/10.1126/science.185.4157.1124; C. Jolls, C. R. Sunstein and R. Thaler, A Behavioral Approach to Law and Economics, (1998) (50) *Stanford Law Review,* 1471–1550. DOI: https://doi.org/10.2307/1229304; C. Camerer, S. Isacharoff, G. Loewenstein, T. O'Donoghue and M. Rabinn, Regulation for Conservatives: Behavioral Economics and the Case for „Asymmetric Paternalism", (2003) (151) *University of Pennsylvania Law Review,* 1211–1254. DOI: https://doi.org/10.2307/3312889; A-S. Vandenberghe, Behavioral approach to contract law, in G. DeGeest (ed.), *Contract Law and Economics*, (Edward Elgar Publishing, Cheltenham, 2011) 401–423.

[13] C. R. Sunstein and R. Thaler, Libertarian Paternalism is not an Oxymoron, (2003) (70) *University of Chicago Law Review,* 1159–1202. DOI: https://doi.org/10.2307/1600573

a change tends to strengthen the incentive and the elements under which the same change tends to weaken the incentive.

The models of prevention presented above are based on the classical concept of rationality. For this reason, these models are subject to serious criticism from the theories of bounded rationality. However, even after reviewing these criticisms, these incentive models can still be maintained – empirical evidence can be provided for their existence.[14]

[14] See e.g. B. C. J. van Velthoven, Empirics of Tort, in M. Faure (ed.), *Tort Law and Economics,* (Edward Elgar, Cheltenham, UK and Northampton, MA, 2009).