

Inside Post-Socialist Courts: The Determinants of Adjudicatory Outcomes in Slovenian Commercial Disputes*

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Despite the judiciary's central role in the capitalist market system, micro-level empirical analyses of courts in post-socialist countries are remarkably rare. This paper draws on a unique hand-collected dataset of commercial claims filed at Slovenian courts to examine the determinants of two salient adjudicatory outcomes: whether a case was resolved via trial or settlement and if the case was tried, whether the plaintiff was awarded the initial claim. Consistent with the divergent expectations theory of litigation, we find that trial-based resolution is more likely when the case is complex and less likely when parties use mediation. Addressing sample selection and endogeneity concerns, we show that defendant's legal representation, plaintiff's profitability, and, importantly, court identity are robust predictors of plaintiff victory at trial. Thus, more than two decades after the start of transition in Slovenia, the judicial system is still a source of legal inconsistency and uncertainty.

Well-functioning courts are the foundation of an effective legal order and central institutions of a market economy. Courts are the key not only to upholding property rights, but also to promoting large-scale commerce (see, e.g., Johnson et al. 2002, Dixit 2003). In post-socialist and developing countries in particular, empirical evidence indicates that in order for markets to flourish, laws on the books must be backed by adequate enforcement by the courts (Pistor et al. 2000, Skosples 2012).

Despite the widespread agreement about the importance of courts, rigorous micro-level empirical evidence offering insight into their functioning in the post-socialist region is remarkably rare.¹ With the exception of a handful of studies (see, e.g., Buscaglia and Dakolias 1999, Murrell 2001a, Gadiuta 2012; Dimitrova-Grajzl et al. 2012a, 2012b, 2014), the existing literature is largely limited to descriptive statistics and qualitative analysis (see, e.g., Dietrich 2000,

Anderson et al. 2005, Ng et al. 2008). In particular, aside from Kathryn Hendley's insightful analysis of Russian commercial courts (see, e.g. Hendley 2004, 2005), we are aware of no other published empirical studies utilizing case-level court data to shed light on the inner workings of the post-socialist courts of Central and Eastern Europe and the former Soviet Union.

We take a step toward filling this gap in the literature by examining unique case-level data on commercial claims (i.e. claims between firms and other legal entities) adjudicated in Slovenian courts of first instance. Applied to the Slovenian context, we address questions such as: What predicts trial outcomes? Do disputing parties' characteristics, the type of legal representation, and case specifics matter? When are parties more likely to settle? Does the specific venue of adjudication play a role? The determinants of adjudicatory outcomes have long been of interest to scholars of law and economics across different legal systems. An understanding of the patterns in adjudication within a country's courts is essential for drawing broader lessons about institutional design (see, e.g., Djankov et al. 2003b). The benefits of private litigation as a means of social control of business crucially depend on how court adjudication works in practice; for instance, whether courts apply the law uniformly and whether courts uphold justice rather than favor the powerful. Due to the general "scarcity of data" (Huang et al. 2010a: 789), however, empirical analyses of court-based adjudication are predominantly restricted to the U.S. context (see, e.g., Fournier and Zuehlke 1989, Perloff et al. 1996, Helland and Tabarrok 2002, Bhattacharya et al. 2007).

Slovenia is an interesting and underexplored case for the study of adjudicatory outcomes in courts. A member state of the European Union since 2004, Slovenia has undergone a relatively smooth economic transition. However, more than two decades after gaining independence and abandoning the Yugoslav version of socialism, the country is still struggling with implementing an effective justice system. Court backlogs and delays, as well as judicial corruption, have been a pervasive concern and an obstacle to doing business (see, e.g., Anderson et al. 2005; Zajc 2011).

Our data, drawn from restricted-access court files on commercial disputes, is rich with information about the disputing parties' characteristics and the specifics of each court case. As a consequence, we are able to assess the predictive power of several variables that conceivably shape two salient adjudicatory outcomes: whether a case was resolved via trial or settled; and if tried, whether the plaintiff won the case, that is, was awarded the initial claim. At the micro level, knowledge of the determinants of disputing parties' success at trial is valuable because it allows disputing parties and lawyers to, first, form expectations about possible outcomes of disputes (Hadfield 2004) and, second, weigh the relative costs and benefits of different means of resolving disputes (see, e.g., McMillan and Woodruff 1999, Johnson et al. 2002). This, in turn, enhances the predictability of the legal system at the macro level, a valuable institutional attribute (see, e.g., Hayek 1960) usually lacking in post-socialist countries. A sense of consistency of decision-making across courts and whether courts may be susceptible to subversion also clarifies the relative (in)effectiveness of litigation as a means of

social control of business. Similarly, an understanding of the determinants of the different modes of case disposition is important since different modes of disposition give rise to different costs. Settlements are completed faster than trials, and consume fewer private and public resources. On the other hand, trials "bring the light of public scrutiny into what would otherwise be the dark corners of...social landscape" (Refo 2004: 4) and thus allow for an opportunity to shape and assert public values (Refo 2004, Fiss 1984, Hadfield 2004).

The central methodological problem in assessing the impact of the various determinants of trial outcomes is the likely endogenous selection of the sample of tried cases (see, e.g., Priest and Klein 1984). To address this issue, we utilize, and combine, standard sample selection estimation methods (see, e.g., Heckman 1979) and the approach of Perloff et al. (1996) which explicitly takes into account that the probability of a trial is a function of the disputing parties' estimated success at trial. A wide range of plaintiff, defendant, and case level controls, as well as court fixed effects, further mitigates the sample selection concerns that may arise from the non-random selection of filed cases and the censoring of resolved cases.

Our key findings may be summarized as follows. The likelihood of plaintiff victory at trial is statistically significantly negatively associated with the defendant party's legal representation through an attorney or a law firm. In contrast, plaintiff's representation by attorney or law firm does not appear to affect the likelihood of plaintiff victory at trial. These results, which shed light on the value of external legal advice in commercial dispute resolution, are robust to combining the sample selection methods with an instrumental variable

approach aimed at isolating the exogenous variation in legal representation status of each disputing party.² We also offer a possible explanation for why in our data the effect of legal representation varies with the identity of the disputing party (i.e. plaintiff versus defendant).

The likelihood of plaintiff victory at trial statistically significantly increases with plaintiff's profitability. In corruption-ridden institutional environments, firm profitability proxies for a firm's willingness or ability to pay bribes (Svensson 2003, Clarke and Xu 2004, Rand and Tarp 2012). While short of being 'hard' evidence of judicial corruption, the positive relationship between the plaintiff's success at trial and the plaintiff's profitability is consistent with the hypothesis that Slovenian courts are susceptible to corruption. Neither the plaintiff's nor the defendant's size, as measured by total assets, or their legal form are statistically significant predictors of plaintiff success at trial. The likelihood of plaintiff victory also does not vary with the complexity of the case and the stakes involved.

In line with the predictions of the divergent expectations theory of litigation (Priest and Klein 1984, Waldfogel 1998), the prospects of a case being resolved via trial rather than settlement are statistically significantly greater for the more complex cases, *ceteris paribus*. The likelihood of trial, as conjectured, robustly statistically significantly decreases with the disputing parties' exposure to mediation. We also find that, all else equal, settlement is more likely when the plaintiff is a company or a sole trader enterprise rather than a municipality.

Once we control for parties' expectations about trial outcomes, legal representation does not statistically significantly affect the likelihood of trial.

The principal-agent theory of the client-lawyer relationship (see Shavell 2004: 435-436) predicts that the effect of legal representation on the mode of case disposition is contingent on the attorney fee arrangement. The lack of a robust effect of legal representation on the mode of case disposition in our data can be reconciled in light of the variety of attorney fee arrangements utilized in Slovenia.

Our paper is relevant to the literature on legal change and reform in post-socialist transition (see, e.g., Hay and Shleifer 1996, Pistor 2000, Murrell 2001b, Kovacic 2001). In contrast to many other post-socialist countries that opted for 'big bang' reforms, Slovenian approach to transition was distinctly slow (see, e.g., Rojec et al. 2004). Yet the resulting Slovenian gradualist approach did not emphasize institution-building, which was an essential aspect of the reform strategy stressed by those taking an evolutionary approach (Murrell 1992).

For instance, while the adoption of market-supporting legislation was a high priority at the outset of transition, reform of the ailing court system was not on the early reformers' agenda (see, e.g., Pleskovic and Sachs 1993). This policy perspective resonated with the views that emphasized the importance of law on the books at the expense of investments in legal effectiveness, a perspective later proven to be flawed (see, e.g., Pistor et al. 2000).

A series of court reforms took place only in the mid 2000s, following an external push from the EU.³ The impact of reforms, however, has been limited at best (see, e.g., Zajc 2011, Dimitrova-Grajzl et al. 2012a). Our analysis confirms the notion that reform of the judiciary is a difficult endeavor (see, e.g., Botero et al. 2003,

Hammergren 2007, Decker et al. 2011). Our results indicate that the prospects of parties' success at trial *ceteris paribus* vary from court to court. Moreover, because these jurisdictional effects are large in magnitude, there exist incentives for the litigants to engage in strategic behavior in the choice of adjudication venue, a practice that increases the costs of litigation. Thus, it appears that even more than two decades after the start of transition in Slovenia, the judicial system is still a source of legal inconsistency and uncertainty (see, e.g., Gray and Stiblar 1993). Furthermore, the abovementioned finding that the more profitable plaintiffs on average have more success in court, at the very least, resonates with the ongoing concerns about subversion of justice in Slovenia.

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1. A related survey-based empirical literature (see, e.g., Hendley et al. 2000, Djankov 2003a, Pyle 2006) provides further evidence about the character and usage of courts in post-socialist countries. Shvets (2013) and Lambert-Mogiliansky et al. (2007) are examples of empirical studies that drawn on data about court quality and activity to study firm behavior in post-socialist countries.

2. Hendley et al. (2001) and Waters (2004) illustrate further dimensions of the role of legal profession in the post-socialist world.

3. For example, the 'Lukenda' project, which aimed at increasing the speed of justice, was implemented after a Slovenian citizen Franjo Lukenda filed a lawsuit at the European Court of Human Rights and won the case against the Republic of Slovenia for violation of the right to a hearing within a reasonable time.