2018

Bifurcating Settlements

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Abstract

In settling a lawsuit, parties agree on their obligations to one another, but they need not separately address each issue, claim, or remedy that a trial court would have confronted. The legal system, however, can bifurcate the settlement process, requiring separate resolution of components of a settlement. Bifurcation can protect third parties, for example, by preventing divorcing parents from trading child custody for money. In addition to identifying a wide range of contexts in which preventing trade-offs may be desirable, this Article shows that bifurcation will generally have only modest (and sometimes beneficial) effects on settlement rates.

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For helpful comments, the authors thank Kirsten Carlson, David Fontana, and participants in workshops at the George Washington University Law School and the Wayne State University Law School. For excellent research assistance, the authors thank Komal Shah. All errors are our own.

Introduction

Typically, a civil settlement disposes of the parties' claims without separately resolving each underlying legal issue.[1] A suit sounding in tort and contract, for instance, might settle for a lump sum, without allocating the amount between the different claims.[2] When the plaintiff brings multiple claims or seeks multiple remedies—injunctive relief and damages,[3] or punitive and compensatory damages[4]—the parties may make trade-offs. These trade-offs are to the parties' mutual advantage and are thus usually benign. But in some contexts, such trade-offs may have adverse effects on third parties. In a divorce case, for example, the parties might agree to give a mother more custody in

1 Settlements generally bar reconsideration even of claims that had not been litigated. *See, e.g.*, Nashville, Chattanooga & St. Louis Ry. Co. v. United States, 113 U.S. 261, 266 (1885). Parties, however, can voluntarily choose to settle only some claims. *See, e.g.*, 15A C.J.S. *Compromise & Settlement* § 5 (2017) ("Although the law favors full settlements over partial settlements, the parties may settle any part of a controversy and leave the rest for litigation." (footnote omitted)).

2 *See, e.g.*, Jon O. Shields, Note, *Exclusion of Damages Derived from Personal Injury Settlements: Tax-Planning Considerations in Light of* McKay v. Commissioner, 56 Mont. L. Rev. 603, 603 (1995) (relaying a problem resulting from a lawsuit "grounded in both tort and contract," where the "settlement agreement . . . did not specify which claims were satisfied by the payment"). There is ordinarily no need to allocate damages among claims.

3 It is common for a party seeking injunctive relief to accept monetary relief instead. *Cf.* Ian Ayres & Kristin Madison, *Threatening Inefficient Performance of Injunctions and Contracts*, 148 U. Pa. L. Rev. 45, 47 (1999) ("A potential plaintiff who is owed a duty may, at times, seek inefficient injunctive relief instead of damages merely to induce a defendant (the person owing the duty) to pay an amount higher than expected court-awarded damages.").

4 *See infra* Section III.A.

exchange for less financial support than the parties would expect a court to award,[5] potentially to the children's detriment.

The law might seek to prevent such trade-offs by forcing the parties to negotiate specified issues separately. Much as civil trials are sometimes bifurcated so that some issues are tried separately from others,[6] so too might the law insist on settlement bifurcation. The simplest way of achieving this would be to require the parties to finalize the settlement of certain issues sequentially. Although parties could jointly discuss all the issues in the lawsuit, an agreement on an issue to be determined later in the sequence would be unenforceable if signed at the same time as or before an issue designated for earlier resolution. In the divorce context, a mother could still make a concession on financial support in the hope that her soon-to-be-ex-husband would follow through on a promise to make a concession in a later agreement on child custody. But if she did not entirely trust him, she would not be willing to do so. Settlement bifurcation seeks to take advantage of the mistrust that often pervades litigation, in commercial and tort contexts as well as family law, to thwart trade-offs between different components of a settlement.[7] Especially if parties are required in finalizing the first part of a deal to attest that they understand that the other issues in the lawsuit remain open to negotiation, many litigants will hesitate to make a concession in exchange for an unenforceable promise of later reciprocation.

The idea that the law might require some issues to be settled before others has received only fleeting recognition in the literature: for example, a suggestion at the end of a study on custody litigation[8] and a brief mention in an article on reverse patent settlements.[9] The courts appear to have considered the possibility in just one context—

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5 *See infra* Part II.

6 *See, e.g.*, Steven S. Gensler, *Bifurcation Unbound*, 75 WASH. L. REV. 705, 710–11 (2000) (arguing that bifurcation of issues at trial can improve the accuracy and the efficiency of the justice system); *see also* John P. Rowley III & Richard G. Moore, *Bifurcation of Civil Trials*, 45 U. RICH. L. REV. 1 (2010) (focusing specifically on bifurcation under Virginia law).

7 The more parties trust each other, the less effective bifurcation is. One can distinguish between "calculative trust"—i.e., trust based on recognition of another's incentives—and "emotional trust." *See* Christopher R. Leslie, *Trust, Distrust, and Antitrust*, 82 TEX. L. REV. 515, 529–32 (2004). Bifurcation effectively reduces calculative trust by furnishing economic incentives to break informal agreements incorporating trade-offs. Emotional trust, however, may thwart bifurcation.

8 *See* Scott Altman, *Lurking in the Shadow*, 68 S. CAL. L. REV. 493, 527 (1995) (recognizing the application of bifurcated settlements to custody negotiations); *see also* discussion *infra* Part II.

9 *See* C. Scott Hemphill, *An Aggregate Approach to Antitrust: Using New Data and Rulemaking to Preserve Drug Competition*, 109 COLUM. L. REV. 629, 686 (2009) (recognizing a

class actions—where attorneys' fees and damages for the class are usually jointly negotiated.[10] One case insists on bifurcation,[11] but other cases take the opposite position, and the Supreme Court has rejected settlement bifurcation in a similar context.[12]

A potential reason that the few recognized available forms of settlement bifurcation have gained little traction is that scholars and judges do not want to discourage settlement. This Article shows, however, that significant reductions in settlement are unlikely.[13] Indeed, when litigation is relatively expensive, bifurcation may enhance the likelihood of settlement. As litigation stakes rise in comparison to trial costs, parties are much less likely to settle because they have more to gain from strategic bargaining. It thus may be more than twice as difficult to settle a claim for a million dollars than to settle a claim for half a million, holding litigation costs roughly constant. Breaking a settlement negotiation into smaller chunks through bifurcation may thus promote settlement. At the very least, any reduction in the probability of settlement attributable to bifurcation is likely small. Thus, bifurcation is worth considering if there are sufficient benefits.

With the recognition that bifurcation is affordable comes a need to theorize about different contexts in which it may be beneficial. Absent a clearly identified benefit, bifurcation is inappropriate because allowing trade-offs will often promote the most efficient allocation of resources between the parties. Consider a nuisance case seeking both damages and injunctive relief. Partial abatement of a nuisance might be impossible,[14] so any compromise must involve exchange of money. Or, in a trademark case, a settlement might allow continued use in exchange for a royalty payment from the defendant, or disallow it in exchange for a compensation payment from the plaintiff.[15] When two

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potential solution to the reverse payments problem in patent law); *see also* discussion *infra* Section III.B.

10 *See infra* Section III.C.

11 *See* Prandini v. Nat'l Tea Co., 557 F.2d 1015, 1021 (3d Cir. 1977).

12 *See* White v. N.H. Dep't of Emp't Sec., 455 U.S. 445, 452 (1982) (discussing fee determinations in civil rights cases).

13 *See infra* Part I.

14 Partial abatement may be possible where a party can reduce its nuisance activity without eliminating it completely. *See, e.g.*, Thomas W. Merrill, *Golden Rules for Transboundary Pollution*, 46 DUKE L.J. 931, 1014–15 (1997) (discussing polluter's agreement for partial abatement).

15 *See* Charles J. Faruki, *Litigation Involving Trademarks: Preparing the Trademark Case for Trial*, 16 U. DAYTON L. REV. 85, 125 (1990) ("Payment to the defendant for a change of name may be possible, and indeed may be the only way to avoid litigation when each side has an investment in its own trademark.").

parties reach an out-of-court settlement, they are presumably satisfied that the settlement is in their mutual interest. Ordinarily, the legal system's only interest is in enforcing the deal that the parties have struck.

Sometimes, however, preventing parties from making trade-offs or insisting that parties disclose how they resolved individual issues is beneficial, particularly when the settlement affects a third party. For example, punitive damages negotiations may affect the government, either because such damages are taxable[16] (but compensatory damages are not) or because of a statute requiring partial forfeiture of punitive damages to the government.[17] Bifurcating settlements may thwart the litigants' ability to allocate the portion of a settlement reflecting expectation of punitive damages to compensatory damages.[18] Similarly, consumers have an interest in settlements of intellectual property disputes,[19] yet litigants may use settlements to collude to keep prices high.[20] Bifurcation would prevent private litigants from making trade-offs at the expense of consumers. In shareholder and class action litigation, shareholders or class members have an interest in assuring that representatives do not prioritize attorneys' fees over other forms of relief, and bifurcating attorneys' fees from other issues may promote this interest.[21] These examples highlight that scholars and policymakers should consider bifurcation in any context in which parties may make trade-offs at the expense of third parties.

Part I scrutinizes the assumption that bifurcation will decrease the likelihood of settlement. Bifurcation may actually *increase* the likelihood of settlement when legal costs are relatively high. Part II offers a detailed analysis of bifurcation in the family law context. Di-

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16 *See, e.g.*, 26 U.S.C. § 104(a)(2) (2012) (allowing deductibility of "any damages (other than punitive damages) received . . . on account of personal physical injuries"); Comm'r v. Glenshaw Glass Co., 348 U.S. 426 (1955) (holding punitive damages to be taxable income).

17 *See generally* Paul F. Kirgis, Note, *The Constitutionality of State Allocation of Punitive Damage Awards*, 50 WASH. & LEE L. REV. 843 app. (1993) (collecting statutes). Many such statutes have been repealed, perhaps in part because they were so easily evaded. *See, e.g.*, COLO. REV. STAT. ANN. § 13-21-102(4) (West 1989) (repealed) (requiring 33% of punitive damages awards to be paid to the state).

18 *See infra* Section III.A.

19 Nonetheless, they may not have standing to assert claims. *See* Einer Elhauge & Alex Krueger, *Solving the Patent Settlement Puzzle*, 91 TEX. L. REV. 283, 324 (2012) ("[P]atent law ordinarily does not allow buyers to sue to prevent the anticompetitive exclusion of rivals through invalid patents.").

20 *See generally* C. Scott Hemphill, *Collusive and Exclusive Settlements of Intellectual Property Litigation*, 2010 COLUM. BUS. L. REV. 685 (discussing the danger that collusive settlements may adversely affect consumers of intellectual property goods).

21 *See infra* Section III.C.

vorce is a rich context for analyzing bifurcation, not only because it illustrates the potential benefits of a bifurcation regime in preventing trade-offs that may harm the interests of third parties, but also because it highlights potential challenges of bifurcation. One concern is that bifurcation may reduce the likelihood that parents will reach the custody arrangement that best promotes their children's interests by limiting the ability of parents who care more about custody to sacrifice financial well-being for assurance of custody. This concern, which we term "the Solomonic problem," illustrates both the information-producing function of trade-offs and the corresponding role of trade-offs in promoting settlement accuracy. Another problem is that parties may make de facto trade-offs after a judgment is rendered. Finally, Part III canvasses other contexts in which settlement bifurcation may be useful if the costs are sufficiently low, including punitive damages, reverse payments in patent law, and class action attorneys' fees. In some of these contexts, scholars have offered imperfect substantive-law tweaks to problems without considering the procedural solution of bifurcation. In others, there has been occasional recognition that settlement might profitably be conducted sequentially, but this possibility has received little consideration.

Overall, this Article demonstrates that settlement bifurcation may be a useful tool when settlements may have negative effects on unrepresented third parties. There is a risk that bifurcation may decrease settlement, but that risk is not as great as might initially appear. Bifurcation prevents parties from making trade-offs in settlements at the expense of third parties.

I. Modeling the Effect of Bifurcation on Settlement Rates

Section I.A demonstrates that bifurcation has multiple effects, some of which increase the risk of trial and some of which decrease it. Section I.B assesses the combination of these competing effects with a simple simulation model. The case for bifurcation strengthens as litigation costs increase relative to the stakes. With sufficiently high litigation costs, bifurcation may even *increase* the likelihood of settlement. Even where settlement becomes less likely, the costs of bifurcation may be quite small. The benefits of bifurcation—identified in Parts II and III—thus need not be high to justify the costs.

A. The Effects of Separate Negotiation

Sometimes, it may be beneficial for settlement negotiators to discuss specifically their separate expectations of two issues, such as compensatory and punitive damages, rather than just exchange gross damages amounts. But there are currently no rules mandating this practice. Perhaps a rule bifurcating settlements may help structure negotiation discussions in the same way that a mediator can serve that role.[22] A rule requiring parties to agree formally on two components of some aggregate number, rather than only on the aggregate number, adds at least one variable they must resolve and thus increases the potential for some additional challenge to the settlement process. Once the parties settle one issue, they must still settle the other issue. A prime driver of settlements is the parties' expectation that they will save on continuing litigation and on trial. But if settling one issue merely reduces the probability of trial—because trial will still occur if another issue fails to settle—then the benefits of settlement are reduced, and the incentive to settle is reduced as a result. On the other hand, it may be easier to settle the first issue rather than the entire case because a single issue is simpler and involves lower stakes than the case as a whole.

To analyze more rigorously the effects of bifurcating, we can begin with simple observations about the causes of settlement failure. Because trial is costly, there will always be a range of settlement values better for both parties than the ultimate case outcome.[23] For example, if a plaintiff would receive $1,000,000 at trial and each party would pay $100,000 in trial costs, then any settlement between $900,000 and $1,100,000 would be mutually advantageous. Even if both parties knew the trial outcome with certainty, however, a case may not settle because the parties engage in strategic bargaining,[24] seeking a relatively favorable value within this range. The more significant contributor to settlement failure is that parties may predict dif-

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22 *See* Evan Slavitt, *Using Risk Analysis as a Mediation Tool*, DISP. RESOL. J., Nov. 2005–Jan. 2006, at 18 (highlighting the mediator's role in breaking down issues).

23 "In the standard model of litigation, settlement range is defined as the set of settlement offers that both the plaintiff and defendant would prefer to going to trial." Tai-Yeong Chung, *Settlement of Litigation Under Rule 68: An Economic Analysis*, 25 J. LEGAL STUD. 261, 267 (1996) (emphasis omitted). Absent uncertainty about trial outcomes, a settlement range will always exist. *See* Russell Korobkin & Chris Guthrie, *Psychological Barriers to Litigation Settlement: An Experimental Approach*, 93 MICH. L. REV. 107, 112 (1994) ("As long as the costs of trial are higher than the costs of settlement, and as long as both sides make an identical estimate of the likely outcome of the trial, the case should settle." (footnote omitted)).

24 *See* Robert Cooter et al., *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. LEGAL STUD. 225, 226, 245–46 (1982).

ferent trial outcomes.[25] These considerations are related. Each party will want to convince the other that its offer reflects its expectation of the litigation result, even when it is really engaging in strategic bargaining.

There are two contingencies that make settlement failure more likely. First, a particular case will be less likely to settle if the parties are mutually optimistic about the outcome—i.e., the plaintiff's expectation of its probability of success is greater than the defendant's expectation of the plaintiff's probability of success and vice versa. This could be the result of a cognitive optimism bias,[26] or it could be the result of the parties having different information or different good-faith interpretations of the same information. Second, settlement is less likely when trial costs are relatively low in comparison to claim stakes. For example, a plaintiff who expects to receive $1,000,000 at trial would settle for no less than $900,000 (90% of claim value) if its trial costs would be $100,000. But if the plaintiff expects to receive $500,000 with the same trial costs, the plaintiff would be willing to settle for no less than $400,000 (just 80% of claim value). A billion-dollar case that would cost a million dollars to litigate will go to trial if the parties are even a bit mutually optimistic; a thousand-dollar case that would cost a million dollars to litigate will almost never go to trial, even if the parties are highly mutually optimistic.

With this background, we can analyze the effects of bifurcation more rigorously. Suppose a plaintiff has two claims against a defendant, Claim 1 and Claim 2. These claims, we will assume for now, are both drawn from the same distribution—Claim 1 is equally likely to be larger or smaller than Claim 2—but are independent. In the traditional settlement regime, the parties settle Claim 1 and Claim 2 aggregated together, so each party estimates each claim, sums these estimates, and negotiates with the other party about the total payment. With what we will call "seriatim bifurcation," the parties start by negotiating Claim 1, and only if that is successful, negotiate Claim 2. An alternative approach to bifurcation that we call "severable settlements" is discussed below.[27]

To begin our analysis of bifurcation, assume that Claim 1 has settled in accordance with the game-theoretic strategy of backward in-

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25 *See, e.g.*, J.J. Prescott & Kathryn E. Spier, *A Comprehensive Theory of Civil Settlement*, 91 N.Y.U. L. Rev. 59, 61–62 (2016).

26 *See, e.g.*, Korobkin & Guthrie, *supra* note 23, at 166.

27 *See infra* Section I.B.2.

duction. Game theory generally proceeds by backward induction,[28] because an earlier stage (for us, evaluation of Claim 1) depends on what is expected to happen at the end of the game (for us, evaluation of Claim 2 if Claim 1 is settled). Will it be easier to negotiate Claim 2 alone than to negotiate Claim 1 *plus* Claim 2? The likelihood of settlement will be greater when the ratio of trial costs to stakes is higher, so we must consider the numerator and denominator of this ratio. A trial on Claim 2 alone may be cheaper than a trial on Claim 1 plus Claim 2. Thus, the numerator of the ratio will be lower when negotiating Claim 2 alone. This will tend to make Claim 2 *more difficult* to negotiate than the sum of Claim 1 plus Claim 2. It seems unlikely that this effect will be large, however. A trial has high fixed costs, and if there is some factual connection between the claims, the marginal savings from not having to litigate Claim 1 are likely to be small. Meanwhile, the social cost of any increase in the incidence of trial resulting from lower trial costs will be reduced by the fact that such trials would be less expensive.

The denominator effect is likely to be greater. The *stakes* will be lower when negotiating Claim 2 alone. Because the stakes will likely decrease more than trial costs, Claim 2 is likely to be easier to settle than Claim 1 and Claim 2 in the aggregate. This brings us to the analysis of Claim 1. This is more complicated because we cannot be sure when settling Claim 1 whether Claim 2 will be settled, with the expenses of trial averted. Thus, we must consider the *expected* trial cost savings of the Claim 1 negotiation relative to the stakes of Claim 1. When calculating the reduced trial costs that are the benefit of settlement, we thus must multiply the trial costs by the probability that Claim 2 settles, because Claim 1's resolution will avoid trial only if Claim 2 settles as well. The benefit of settling Claim 1 is then less than the benefit of settling Claim 2. Continuing our assumption that a trial involves fixed costs regardless of how many claims are at issue, Claim 1 alone should on average therefore be more difficult to negotiate than Claim 2 alone. The probability of successfully settling Claim 1 and *then* Claim 2, meanwhile, will be the product of these probabilities. This probability ultimately must be compared to the probability of negotiating the two claims when aggregated.

It might seem that negotiating two small claims will be much harder than negotiating a single larger claim. With sufficiently low trial costs, this would be true. If litigation is costless, then a negotia-

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28 *See, e.g.*, MARTIN J. OSBORNE & ARIEL RUBINSTEIN, A COURSE IN GAME THEORY 99–100 (1994).

tion will fail as a result of mutual optimism half of the time, whenever the plaintiff's estimate of the probability of liability is higher than the defendant's. Thus, with bifurcation, regardless of the claim value, there will be a 75% trial rate, as settlement occurs only where both of the individual settlements succeed. This highlights that the more items there are to be negotiated, the more potential sources of settlement failure exist.

The countervailing point is that once trial costs are sufficiently large and settlement becomes very common, settlement rates will be much higher with each small claim than with the larger claim. As soon as trial costs are positive, the probability of settling a small claim will be higher than the probability of settling a large claim. The higher the stakes, the less important the trial costs, and thus the greater the chance of settlement failure. Critically, the discrepancy in settlement rates between each small claim and the larger claim becomes ever larger as trial costs increase. For example, if there is a 5% chance that parties would be so mutually optimistic that they would fail to settle the large claim, there might be only a 1% chance that parties would be so mutually optimistic that they would fail to settle one of the small claims. As trial costs increase, the probability of settlement failure approaches zero twice as fast with the small claim as with the larger one. Thus, settlement failure becomes much more likely with the larger claim, and this is enough to compensate for the challenges associated with settling two smaller claims.

B. Bifurcating Independent Claims

1. Bifurcated vs. Aggregated Settlements

A simple numerical analysis makes this intuitive explanation more precise, providing a foundation for a later, more elaborate simulation analysis. The law-and-economics literature assessing the effects of different rules on the likelihood of settlement and trial relies largely on formal mathematical modeling,[29] but our approach is consistent with that of other works using mathematical analysis augmented by simple examples[30] or simulations.[31] We use a simple numerical ap-

29 *See, e.g.*, Lucian Arye Bebchuk, *Litigation and Settlement Under Imperfect Information*, 15 RAND J. ECON. 404 (1984) (analyzing the effect of one-sided information); A. Mitchell Polinsky & Daniel L. Rubinfeld, *Does the English Rule Discourage Low-Probability-of-Prevailing Plaintiffs?*, 27 J. LEGAL STUD. 519 (1998) (analyzing the effect of fee shifting).

30 *See, e.g.*, Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55 (1982) (offering an analysis of different fee shifting rules).

proach here because modeling two-sided imperfect information analytically is challenging,[32] even when parties are seeking to resolve only a single claim. Perhaps in part because of the challenges of mathematical modeling, the law-and-economics literature has generally focused on situations involving only a single claim, and even there has generally assumed either perfect information or one-sided information (i.e., one party knows the result with certainty, but the other party knows only the distribution of possible results).[33] We must analyze continuous two-sided information for each of two claims.

Ignore for the moment whether a party has an incentive to give up. Rather, simply assume, as is common in the literature,[34] that a claim will settle so long as there *is* a settlement range, that is, so long as the plaintiff's valuation exceeds the defendant's by no more than the sum of the expected costs that settlement would save. We implemented the model under this assumption through Monte Carlo techniques,[35] simulating a settlement negotiation 1,000,000 times for each scenario. Each iteration of the simulation works as follows:

- For each of Claim 1 or Claim 2, a claim value is drawn at random from a uniform distribution between $0 and $1000.
- Then, each party receives a separate *signal* of claim quality that is equal to the *actual* claim value plus a random noise value, drawn from a normal distribution with a standard deviation of $100.
- Each party then makes a valid Bayesian inference about the expected claim value based on this inference. If Claims 1 and 2 are aggregated, each party sums its valuations of the two claims.

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31 *See, e.g.*, George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 22–28 (1984) (providing simulations to bolster an analytical model).

32 *See, e.g.*, Daniel Friedman & Donald Wittman, *Litigation with Symmetric Bargaining and Two-Sided Incomplete Information*, 23 J.L. ECON. & ORG. 98, 99 (2007) (offering a complex mathematical model).

33 *See, e.g.*, A. Mitchell Polinsky & Daniel L. Rubinfeld, *Optimal Awards and Penalties When the Probability of Prevailing Varies Among Plaintiffs*, 27 RAND J. ECON. 269, 270–71 (1996).

34 *See, e.g.*, Steven Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J. LEGAL STUD. 1, 11 (1995) ("[T]he difference between the plaintiff's expected judgment and the defendant's expected judgment must exceed the sum of their trial costs for there to be a trial; otherwise they will settle to save trial costs.").

35 *See generally* RiskAMP, What Is Monte Carlo Simulation?, https://www.riskamp.com/files/RiskAMP%20-%20Monte%20Carlo%20Simulation.pdf [https://perma.cc/C8Z3-KAL4].

- A negotiation is assumed to fail when the plaintiff's valuation exceeds the defendant's by more than a posited settlement range.

For each value of litigation costs, there were three distinct scenarios: Claims 1 and 2 aggregated, Claim 2 alone, and Claim 1 alone (discounting the settlement range by the probability that Claim 2 will be negotiated successfully).

Figure 1 summarizes the results. The x-axis represents the size of the settlement range. This is the combined expenditure on litigation costs that settlement will avoid. For each settlement range, the leftmost two bars represent, respectively, the probability of settlement failure of Claim 2 on the assumption that Claim 1 has succeeded, and the probability of settlement failure on Claim 1 without knowing the result of Claim 2. As explained above,[36] the probability of settlement failure is higher for Claim 1 than for Claim 2 because the possibility that Claim 2 might fail to settle reduces the benefit of settling Claim 1. Meanwhile, the third bar shows the probability of trial with bifurcation (that is, the probability either that Claim 1 will not be settled or that, after Claim 1 is resolved, Claim 2 will fail to settle). Finally, the fourth bar shows trial rates when Claims 1 and 2 are aggregated together.

The data suggest that any increase in the likelihood of trial attributable to bifurcation is not likely to be severe—and surprisingly, that bifurcation might produce *more* settlements than aggregated settlements. When the settlement range is only $50—that is, the expected cost of litigation is only one-tenth of the average case value—then the trial rate with bifurcated settlements is considerably higher than when claims are aggregated: 57.4% vs. 37.9%. This gap narrows as the settlement range becomes greater. Once the settlement range is above $200, bifurcated settlements produce a lower trial rate (10.5%) than aggregated settlements (11.6%). The gap becomes more pronounced as the settlement range continues to rise. The reason for this is that the rate of settlement failure for each claim individually—the two bars on the left of each group—becomes much lower than the rate of settlement failure for the two claims when aggregated. It is fairly unlikely that mutual optimism will block settlement when $1000 is at stake and trial costs are $300, but it is extremely unlikely when only $500 is at stake and trial costs are still $300.

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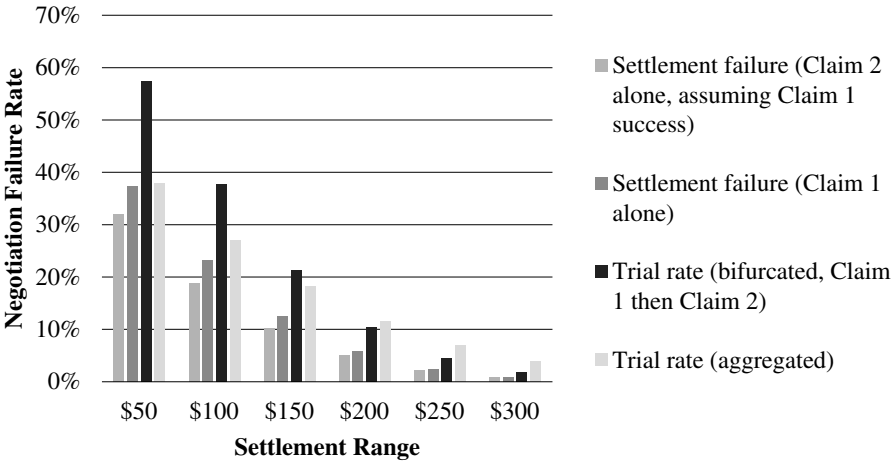
36 *See supra* Section I.A.

FIGURE 1. NEGOTIATION FAILURE RATES FOR SEPARATE CLAIMS WITH BIFURCATED AND AGGREGATED SETTLEMENTS



This analysis does not justify a mandatory regime of bifurcation in the absence of some other consideration.[37] After all, there is nothing to stop parties from negotiating Claim 1 before Claim 2 even if the law does not require them to negotiate.[38] In practice, however, parties rarely reach partial settlements and continue negotiating, so creating a mandatory regime might be helpful. In any event, the analysis does provide some evidence that if there is an affirmative reason to insist on bifurcation, the costs of doing this may be quite low or nonexistent.

A legislature should, however, tread carefully before adopting any bifurcation regime based on this analysis, ideally implementing bifurcation as a pilot project subject to rigorous examination.[39] There are three reasons that caution is appropriate. First, the model does not take into account the possibility of deviations from rational behavior. Second, the model is quite stylized: it does not take into account structural factors, such as the plaintiff's option to drop a claim.[40] Third, the model focuses on asymmetric information as the source of bargaining failure, but strategic bargaining may also lead to bargaining failure. Cases in which both parties are aggressive bargainers for reasons other than their valuations are less likely to settle. Importantly, bar-

37 *See, e.g.*, *infra* Parts II, III.

38 *See* 15A C.J.S., *supra* note 1.

39 *Cf.* Laurens Walker, *Perfecting Federal Civil Rules: A Proposal for Restricted Field Experiments*, 51 LAW & CONTEMP. PROBS. 67, 67 (1988) (urging greater experimentation in civil procedure).

40 *See* Peter H. Huang, *Lawsuit Abandonment Options in Possibly Frivolous Litigation Games*, 23 REV. LITIG. 47, 50 (2004) (exploring the implications of option theory for modeling litigation).

gaining aggressiveness seems likely to be correlated across different claims. This consideration, however, *reduces* the risks of bifurcation. If settlement failure for Claims 1 and 2 are correlated, then the fact that Claim 1 settles suggests that the parties are not being especially aggressive, meaning that Claim 2 is highly likely to settle as well.

2. Severable Settlements

An alternative to seriatim bifurcation is to use severable settlements. This approach would permit an initial comprehensive settlement but allow either party to back out of a portion of it. The provisions of the settlement agreement would thus be "severable," much like statutory provisions that stand even if courts void others on judicial review.[41] Withdrawal from agreement on an issue would require further negotiation or trial. A party might be required to notify a court or a third-party information escrow agent[42] if it wished to back out of part of an agreement. Critically, the court or agent would inform the other party only after the withdrawal deadline, so a party backing out of one part of an agreement would not worry that doing so would trigger the other party to back out of the other part. An advantage of severable settlements relative to seriatim bifurcation is that they require greater trust among the parties to circumvent. Seriatim bifurcation will fail so long as a party making a concession on Claim 1 trusts its opponent, because once a concession is made on Claim 1, the concession is irreversible; severable settlements will fail only if *each* party trusts its opponent, because either party may defect from cooperation at any time.

We can model severable settlements by imagining separate lawyers negotiating Claim 1 and Claim 2, each recognizing that the other negotiation may fail. The benefits of a successful negotiation are thus discounted in each case by the probability of a successful negotiation in the other case. If there is only an 80% chance that the other case will settle, then the settlement range is 80% as large. Because Claim 1 and Claim 2 are drawn from the same distribution, we must find a value p so that when one other claim will settle with probability p, the claim being negotiated will also settle with probability p. By zeroing in on this equilibrium, we can determine the probability value with sev-

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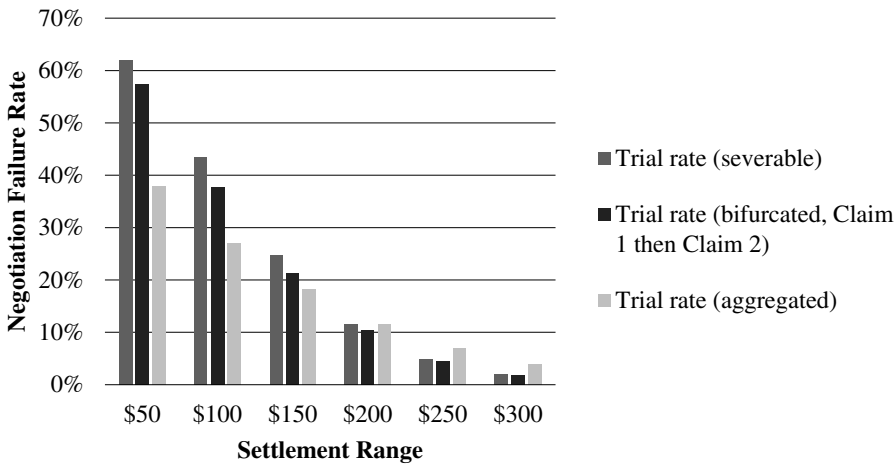
41 *See generally* John Copeland Nagle, *Severability*, 72 N.C. L. REV. 203 (1993) (discussing judicial doctrine concerning severability provisions).

42 *See* Ian Ayres & Cait Unkovic, *Information Escrows*, 111 MICH. L. REV. 145, 150 (2012) (defining an "information escrow" as "a mechanism of conditional, *intermediated* communication").

erable settlements. That is, for a particular settlement-range value parameter and a particular assumption about the settlement rate for the other claim, the simulation iterates 1,000,000 times to determine the settlement rate for this claim; it then adjusts *p* and repeats, until the two values are arbitrarily close to one another. Figure 2 illustrates the result, alongside the trial rates for bifurcation and for aggregated claims.

FIGURE 2. NEGOTIATION FAILURE RATES FOR SEVERABLE, SERIATIM, AND AGGREGATED SETTLEMENTS



Trial rates with severable settlements are slightly above the trial rate with seriatim bifurcation. With bifurcation, Claim 1 is more difficult to negotiate because of the possibility that the parties may fail to resolve Claim 2. With severable claims, *each* claim is more difficult as a result of the possibility that the other may not be resolved. A severable claim is more difficult to resolve than Claim 2 would be because the expected costs savings must be multiplied by the probability of negotiation success. Moreover, a severable claim will be more difficult to resolve than Claim 1 would be because when negotiating Claim 1, the expected costs savings are multiplied by the probability of negotiation success with Claim 2, which is the easiest of the claims to resolve. Thus, negotiating two severable claims will be more difficult than negotiating two bifurcated claims seriatim—but not much more difficult. As illustrated in Figure 2, the negotiation failure rates are only slightly less, especially with larger settlement ranges. As before, once the settlement range becomes sufficiently high (around $200), severable settlements produce lower trial rates than aggregated settlements.

The comparison between bifurcated and severable settlements provides some argument in favor of the latter, but psychology may be as important as economics in choosing between these regimes. A downside of severable settlements is the risk that each party may worry, sometimes with good reason, that the other party is agreeing to settle one claim (or one aspect of a claim) as a gesture that the other party will then repudiate. This is, of course, the point—the goal is for each party to negotiate each part of the settlement with the expectation that the other might still be negotiated—but it could increase feelings of mistrust between the parties. On the other hand, perhaps some deception about the acceptability of one part of a settlement will *facilitate* settlement of another part of a claim. In addition, parties might feel more comfortable agreeing to resolution of one part of a settlement if they have what they believe is at least a tentative agreement on another. Seriatim bifurcation imposes a structure to the settlement process, thus largely removing parties' need to determine whether the other party is only pretending to agree to a settlement. On the other hand, addressing one issue before another may be artificial, preventing the parties from considering the issues in the order that may seem most natural given the particular facts.

II. Protecting Children in Divorce Cases

Scholars have long held up custody settlements as a paradigmatic instance of negotiations vulnerable to improper trade-offs.[43] While the empirical frequency of trade-offs is debated,[44] many scholars contend that the parent more invested in custody will often trade away marital property, spousal support, or child support for a greater share of cus-

43 *See* Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 Yale L.J. 950, 964–65, 979–80 (1979) (observing that "a parent may, over some range, trade custodial rights for money," and that the uncertainty of prevailing child custody standards has the "ironic and tragic result" of disadvantaging the parent more invested in custody); *see also, e.g.*, Richard Neely, *The Primary Caretaker Parent Rule: Child Custody and the Dynamics of Greed*, 3 Yale L. & Pol'y Rev. 168, 179 (1984) ("The everyday occurrence of children being traded for money should be sufficient in and of itself to prompt a reevaluation of a system that turns custody awards into bargaining chips."); Elizabeth S. Scott, *Pluralism, Parental Preference, and Child Custody*, 80 Calif. L. Rev. 615, 651 (1992); Jana B. Singer, *The Privatization of Family Law*, 1992 Wis. L. Rev. 1443, 1550.

44 *See, e.g.*, Eleanor E. Maccoby et al., Dividing the Child: Social and Legal Dilemmas of Custody 160 (1992) ("[C]ontrary to popular perception, most divorce decrees do not reflect a trade-off between custody and money issues."); Margaret F. Brinig & Michael V. Alexeev, *Trading at Divorce: Preferences, Legal Rules and Transactions Costs*, 8 Ohio St. J. on Disp. Resol. 279, 292 (1993) ("[C]ontrary to the accepted wisdom, tradeoffs between custody and property may not always be present.").

tody.[45] Some claim that the less-invested parent may threaten to initiate custody litigation to pressure the other parent to make such trade-offs.[46] We start with custody settlements as our initial case study of bifurcation not because this is the strongest or most straightforward possible application. To the contrary, the complexity of divorce negotiations means that settlement bifurcation in the context of child custody will face obstacles that may not exist for some other applications of bifurcation. Our aim is to explore settlement bifurcation, not to advocate it as a solution to every problem, and so we start with an application in which bifurcation's benefits and costs may both be high. We will accordingly devote more attention to this application of bifurcation than to others, even though the case for some of the other applications may be stronger.

We are not the first to recognize that the legal system could require resolution of child custody before other issues. Prior commentators, however, have been too dismissive either of bifurcation or of its downsides, and none has devoted more than brief attention to bifurcation of custody settlements or to the broader question of when bifurcation might be justified.[47] The mediation literature mentions the possibility of requiring mediators to address custody separately from property and support.[48] This literature, however, largely rejects such proposals on the assumption that custody trade-offs are inevitable and even desirable, insofar as they increase client satisfaction with the work of private mediators,[49] and it does not recognize the possibility

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45 *See, e.g.*, Altman, *supra* note 8, at 499, 501 (reporting result of survey of California attorneys "confirm[ing] that negotiating tactics aimed at trading custodial time for financial terms are widespread though hardly universal"); Margaret F. Brinig, *Penalty Defaults in Family Law: The Case of Child Custody*, 33 FLA. ST. U. L. REV. 779, 806–07 (2006) (finding some evidence of trade-offs); Martha Fineman, *Dominant Discourse, Professional Language, and Legal Change in Child Custody Decisionmaking*, 101 HARV. L. REV. 727, 761 (1988); Neely, *supra* note 43, at 179; Scott, *supra* note 43, at 647, 651; Singer, *supra* note 43, at 1550.

46 *See* Altman, *supra* note 8, at 495–510; Howard S. Erlanger et al., *Participation and Flexibility in Informal Processes: Cautions from the Divorce Context*, 21 LAW & SOC'Y REV. 585, 597 (1987) ("[A] number of women report that they accepted poor settlement terms because their husbands were threatening custody battles . . . ."); Neely, *supra* note 43, at 177–79; Scott, *supra* note 43, at 647.

47 *See, e.g.*, Craig A. McEwen et al., *Bring in the Lawyers: Challenging the Dominant Approaches to Ensuring Fairness in Divorce Mediation*, 79 MINN. L. REV. 1317, 1340–42 (1995) (discussing attempts to require divorce mediators to resolve economic issues separately from custody).

48 *See id.* at 1341.

49 *See id.* at 1340–42 (finding that "statutes that purport to separate economic from custody/visitation issues probably do not succeed in actually severing these issues or in preventing parties from linking them" during mediation, and citing studies finding that costs are lower and client satisfaction higher when mediators address custody together with financial issues).

that the courts might enforce bifurcation by approving parts of settlements seriatim. One commentator, Scott Altman, does recognize this possibility, briefly considering bifurcation at the end of a study reporting the results of a survey of California lawyers about their experience with custody negotiations.[50] Altman suggests that "[s]ettlement agreements should be submitted in stages."[51] Altman, however, dismisses without elaboration some of the most significant potential downsides to the proposal, including the possibility that settling custody separately might increase litigation rates,[52] or that it might adversely affect negotiated custody outcomes.[53] No jurisdiction appears to have adopted Altman's proposal.

A. The Problem of Custody Trade-Offs

Concern about potential trade-offs between divorcing parents was brought to the fore in the seminal 1979 article written by Robert Mnookin and Lewis Kornhauser on the role of background legal rules in shaping settlement negotiations.[54] Divorcing parents negotiating custody over their children must also resolve issues of marital property division, spousal support, and child support. Mnookin and Kornhauser observed that the parent more invested in custody, even if more likely to be awarded custody at trial, might relinquish rights to property or support rather than risk even a small possibility of "substantially diminish[ing] his or her relationship with the child."[55] The less-invested parent, by contrast, has nothing to lose from threatening to bring an action for primary custody.[56] According to Mnookin and Kornhauser, this dynamic, in conjunction with the indeterminate best-interests standard governing child-custody disputes, has the "ironic and tragic result" of weakening the bargaining position of the "good

50 *See* Altman, *supra* note 8, at 527.

51 *Id.*

52 Altman acknowledges that settling custody separately might incentivize litigation. *See id.* at 529. But he focuses only on the scenario of a parent who litigates custody to obtain a greater share than he desires, with a view to trading it off for financial concessions—a prospect he rejects as unlikely to occur with any frequency because the costs of litigation will typically outweigh financial gains. *See id.* Altman does not explore the possibility that bifurcating settlements might be useful even when both parents genuinely want custody.

53 *See id.* (failing to address this possibility).

54 *See* Mnookin & Kornhauser, *supra* note 43.

55 *Id.* at 979; *see also* Neely, *supra* note 43, at 177 (contending that "husbands will threaten custody fights . . . as a means of intimidating wives into accepting less child support and alimony," and that "[b]ecause women are usually unwilling to accept even a minor risk of losing custody, such techniques are generally successful").

56 *See* Mnookin & Kornhauser, *supra* note 43, at 964–65, 969–71, 978–79.

parent" in divorce negotiations.[57] While courts deciding custody matters often have the option of appointing a guardian ad litem to represent children's interests,[58] when parents settle the matter of child custody, courts rarely second-guess the parents' arrangement.[59]

1. Custody Trade-Offs and Harm to Children

By reducing the share of marital wealth available to custodial parents, custody trade-offs diminish the material well-being of the children who reside with those parents, thus potentially contributing to the high rates of postdivorce impoverishment of caretakers and their children.[60] The primary harm to children that commentators have identified as arising from custody trade-offs is financial.[61] Children are affected not only by child-support awards (which are paid directly to the custodial parent), but also by both the division of their parents' marital property and the presence or absence of an award of spousal support. When a primary caretaker, fearful of losing custody, makes a financial sacrifice in exchange for a desirable custody arrangement, the caretaker's children suffer from a lower standard of living.[62] Children can also be harmed if the primary custodial parent must work more as a result of this trade-off and thus spend less time with them day to day. While spousal support is awarded only in a

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57 *Id.* at 979; *see also* Fineman, *supra* note 45, at 761 ("[M]any women bargain away needed property and support benefits to avoid the risk of 'losing' their children.").

58 *See, e.g.*, CONN. GEN. STAT. ANN. § 46b-54(a) (West 2017); MICH. COMP. LAWS § 722.24(4)(2) (2017) ("If, at any time in [a] proceeding [involving dispute of a minor child's custody], the court determines that the child's best interests are inadequately represented, the court may appoint a lawyer-guardian ad litem to represent the child."); *see also* Barbara Ann Atwood, *Representing Children: The Ongoing Search for Clear and Workable Standards*, 19 J. AM. ACAD. MATRIM. LAW. 183, 192 (2005) (noting that most states allow courts to appoint a guardian ad litem in custody disputes).

59 *See* Brian H. Bix, *Private Ordering and Family Law*, 23 J. AM. ACAD. MATRIM. LAW. 249, 262 (2010) ("[C]ourts tend to rubber-stamp [separation] agreements . . . even for child-related provisions.").

60 Scott, *supra* note 43, at 651 ("When parents are motivated to exchange custody rights for property . . . , such an exchange will result in an unequal property distribution—an outcome that usually threatens the child's future economic welfare."); *see also* Singer, *supra* note 43, at 1550 ("Substantial evidence suggests that the common divorce bargaining practice of a parent trading off financial claims for custody assurances has contributed both to inadequate child support agreements and to the impoverishment of children and their custodial parents after divorce.").

61 *See, e.g.*, Scott, *supra* note 43, at 651 (emphasizing financial harm to children as a result of custody trade-offs); Singer, *supra* note 43, at 1550 (arguing that custody trade-offs contribute to child poverty); *see also* Altman, *supra* note 8, at 512–13 (same).

62 *See, e.g.*, Neely, *supra* note 43, at 178 (arguing that because custody trade-offs reduce both the spousal support and the child support paid to custodial parents, "children are forced to grow up poor, or at least poorer than they should be").

small fraction of cases, one factor that courts consider in awarding such support is whether a caretaker should be awarded an amount of support that would enable her to continue staying home with young children.[63] Where a parent forgoes an award of spousal support in a custody settlement, this may mean that she will return to work sooner than otherwise.

Financial trade-offs also could lead to suboptimal custody allocation, for instance, by detrimentally reducing a child's contact with a noncustodial parent.[64] They could shape other aspects of custodial arrangements as well, potentially in ways adverse to children's interests. Custody settlements commonly address such issues as whether the custodial parent may relocate with the children, how the children shall be raised, and who has the right to make educational, medical, and religious decisions about the children's upbringing.[65] Given the notorious difficulty of assessing which custodial arrangement is in a child's best interests, it is hard to measure to what extent these custody arrangements are better or worse than they would be absent trade-offs. Given the assumption that custody should be determined primarily with reference to children's interests, however, a custody settlement that is shaped in part by trade-offs might be considered less optimal.

Trade-offs between custody and financial matters also could inflict expressive harm on children. Margaret Radin argues that the exchange of money for parental rights commodifies children and demeans children's dignity.[66] While Radin made this point in the context of surrogacy agreements,[67] similar arguments may apply to exchanging money for custody.[68] Indeed, custody law since the early

63 *See, e.g.*, CAL. FAM. CODE § 4320(g) (West Supp. 2017) (instructing courts ordering spousal support to consider, inter alia, "[t]he ability of the supported party to engage in gainful employment without unduly interfering with the interests of dependent children in the custody of the party").

64 *See* Altman, *supra* note 8, at 512.

65 *See* Sarah Abramowicz, *Contractualizing Custody*, 83 FORDHAM L. REV. 67, 82–83, 86–88 (2014) (describing provisions that have been included in custody agreements). While courts often defer to such agreements, they are not bound by them and are particularly reluctant to enforce provisions governing children's religious education, which raise First Amendment concerns. *See id.* at 79–88.

66 *See* Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849, 1909–11, 1925–28 (1987).

67 *See id.*

68 *See, e.g.*, Katharine B. Silbaugh, *Marriage Contracts and the Family Economy*, 93 NW. U. L. REV. 65, 126–28 (1998) (noting the widespread view that "commodifying the child . . . [is] unacceptable"). *But see, e.g.*, Martha M. Ertman, *What's Wrong with a Parenthood Market? A New and Improved Theory of Commodification*, 82 N.C. L. REV. 1, 3–5 (2003) (contending that there are positive aspects to parenthood markets, including enabling family formation on the

nineteenth century has insisted that parental agreements exchanging custody for financial concessions (such as agreements in which a father forfeits his right to visitation in exchange for release from his child-support obligations)[69] are unenforceable because children are not "chattel" to be bought and sold by their parents.[70] The law's ban on explicit trade-offs suggests a perception of harm that would inhere in implicit trade-offs too.

2. *Custody Trade-Offs and Harm to the State*

The state also has an interest in preventing parental trade-offs. As *parens patriae*,[71] the state has a responsibility to protect children. Moreover, given the connection between the conditions of children's upbringing and children's capabilities as adults, the state has an independent interest in ensuring that children are raised in conditions that will render them productive, law-abiding adult citizens.[72] Additionally, family law scholars often characterize family law (somewhat critically) as motivated by a state interest in minimizing the likelihood that parents and their children will require public assistance.[73] While the judiciary in many states can reject marital property and support agreements that will render a former spouse eligible for public sup-

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basis of "intention and function"); Elisabeth M. Landes & Richard A. Posner, *The Economics of the Baby Shortage*, 7 J. LEGAL STUD. 323, 346 (1978) (suggesting that "the benefits of free baby selling might . . . outweigh the costs").

69 *See, e.g.*, Blisset v. Blisset, 526 N.E.2d 125, 128 (Ill. 1988) (refusing to enforce such an agreement on the basis that "[p]arents may not bargain away their children's interests"). *But see* Ferguson v. McKiernan, 940 A.2d 1236, 1238 (Pa. 2007) (upholding agreement terminating parental rights and obligations of known sperm donor).

70 *See, e.g.*, Chapsky v. Wood, 26 Kan. 650, 652 (1881) ("[A] child is not in any sense like a horse or any other chattel, subject-matter for absolute and irrevocable gift or contract."); People *ex rel.* Barry v. Mercein, 3 Hill 399, 410 (N.Y. Sup. Ct. 1842) (rejecting right of father to "violate his duty by selling his children"). Courts used the rhetoric of "chattel" to justify refusing to enforce any contractual transfers of parental rights, including those that did not involve monetary exchange. *See, e.g.*, *Chapsky*, 26 Kan. at 657–58 (refusing to enforce uncompensated transfer of parental rights to adoptive parent); *Mercein*, 3 Hill at 408 (refusing to enforce separation agreement allocating custody to wife).

71 *See* Naomi Cahn, *State Representation of Children's Interests*, 40 FAM. L.Q. 109, 112 (2006) (characterizing the *parens patriae* doctrine as "the basis for any state intervention on behalf of children in the family based on a belief that the state has a duty to act in the best interest of the child").

72 *See* Anne C. Dailey, *Developing Citizens*, 91 IOWA L. REV. 431, 432–34 (2006) (demonstrating how the conditions in which children develop shape their ability to function as rational and deliberative adult citizens).

73 *See, e.g.*, Melissa Murray, *Family Law's Doctrines*, 163 U. PA. L. REV. 1985, 2013 (2015) (identifying "privatizing dependency" as a central commitment of family law).

port,[74] there are less obvious ways in which a financial settlement between divorcing parents may impose costs on the state.[75]

3. Custody Trade-Offs and Improper Leverage

Much of the literature on custody trade-offs expresses concern with the harm these trade-offs inflict, not only on children, but also on the parent who relinquishes financial resources in exchange for custody.[76] Commentators have long noted that the parent less invested in custody will often make a disingenuous threat to litigate custody—that is, a threat to request a custodial allocation that the parent neither desires nor expects to receive—in order to extract financial concessions from a parent fearful of even a small risk of losing primary custody.[77] Scholars and judges have characterized such tactics as "extortionate bargaining"[78] and "blackmail."[79]

It may be tempting to frame this concern with harm to the parent as paternalistic. After all, both parents must freely consent to any settlement, and, if a parent willingly trades money or property for custody, why not respect her own preferences on the matter? The scholarly tendency is to characterize the disingenuous threat to litigate custody as coercive,[80] which, by implicitly characterizing the threatened parent as vulnerable and thus in need of special protections, raises the specter of paternalism. But a disingenuous threat to litigate custody is problematic for reasons unrelated to the power dynamic between divorcing parents. Where a parent threatens to litigate

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74 *See, e.g.*, UNIF. PREMARITAL AGREEMENT ACT § (6)(b) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1983).

75 For instance, the state may ultimately pay more in medical costs if a former spouse is rendered unable to afford preventive medical care. *See* J. Thomas Oldham, *Changes in the Economic Consequences of Divorces, 1958–2008*, 42 FAM. L.Q. 419, 446 (2008) (discussing how divorce increases eligibility for Social Security and Medicare costs).

76 *See, e.g.*, Fineman, *supra* note 45, at 760–61 (contending that prevailing custody allocation process "produces bad decisions for many women and children"); Singer, *supra* note 43, at 1549 ("[L]egal rules that grant unfettered discretion to private individuals to structure the process of marital dissolution or that place dissolution-related disputes outside the 'shadow of the law' may end up empowering economically stronger family members at the cost of economically weaker ones . . . .").

77 *See, e.g.*, Altman, *supra* note 8, at 494–510; Neely, *supra* note 43, at 177–79; Scott, *supra* note 43, at 647.

78 *See, e.g.*, Neely, *supra* note 43, at 171 (characterizing custody litigation threats as "extortionate bargaining").

79 *See, e.g.*, Jana B. Singer & William L. Reynolds, *A Dissent on Joint Custody*, 47 MD. L. REV. 497, 516 (1988) (characterizing disingenuous threats to request joint custody as "custody blackmail").

80 *See, e.g.*, Altman, *supra* note 8, at 513–14 (evaluating whether it is coercive to threaten custody litigation in order to extract a better financial settlement).

custody solely in order to extract a more advantageous financial settlement, such a threat is a form of nuisance claim—a threat to bring a claim that has only a low probability of success, solely for the purpose of extracting a settlement. The legal system seeks to prevent nuisance claims, recognizing that the use of such claims to extract settlements is improper and adverse to social welfare.[81] Where litigants append nuisance claims to legitimate ones, as a parent does by making a disingenuous threat to litigate custody in order to extract a desirable settlement on property allocation and support, the leverage that this creates similarly exerts improper pressure and skews settlement results.

B. Previous Approaches to Custody Trade-Offs

Although family law scholars have recognized the potential dangers of trade-offs in custody negotiations, aside from Altman's brief treatment,[82] neither scholars nor courts have considered settlement bifurcation. Instead, they have considered a variety of other approaches to reducing trade-offs. Similar strategies might be applied beyond family law in other contexts where trade-offs affect third parties, and examining them highlights the comparative simplicity of settlement bifurcation.

1. Changes to the Substantive Law

The tendency to look to background legal rules to address the problem of custody trade-offs originated with Mnookin and Kornhauser.[83] They argued that the indeterminate "best interests of the child standard" that currently prevails in family law makes child-custody outcomes especially difficult to predict.[84] This uncertainty, they argued, contributed to the risk aversion[85] of "good parents" so fearful of even the smallest chance of losing custody that they might trade away property and support to guarantee a desirable custody outcome.[86] Mnookin and Kornhauser hypothesized that making custody

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81 *See* Randy J. Kozel & David Rosenberg, *Solving the Nuisance-Value Settlement Problem: Mandatory Summary Judgment*, 90 VA. L. REV. 1849, 1851–52 (2004) ("The resulting settlements decrease social welfare by vexing and taxing the victimized party, encouraging the misallocation of legal resources, and diminishing public confidence in the civil liability system.").

82 *See* Altman, *supra* note 8, at 527.

83 *See* Mnookin & Kornhauser, *supra* note 43, at 977–80.

84 *Id.* (emphasis omitted).

85 *See id.* at 979 (characterizing the parent who significantly prefers the certainty of a moderate amount of custody to a risk of losing substantial custody as "risk-averse").

86 *See id.*

rules more determinate would reduce strategic bargaining and thereby help to prevent trade-offs.[87] They also noted that rules that are both more determinate and more favorable to the primary caretaker parent (such as a maternal preference, a version of which preceded the more open-ended best-interests standard) would have the additional effect of strengthening the bargaining position of the more invested parent.[88]

In subsequent decades, both lawmakers and courts, as well as scholars, have continued to consider how default rules might change to prevent custody trade-offs that work to children's disadvantage. In 1981, in *Garska v. McCoy*,[89] Justice Robert Neely of the West Virginia Supreme Court crafted a new child custody standard intended to address this problem. "Our experience," Justice Neely explained, "instructs us that uncertainty about the outcome of custody disputes leads to the irresistible temptation to trade the custody of the child in return for lower alimony and child support payments."[90] *Garska* thus replaced the best-interests-of-the-child standard with the more determinate "primary caretaker" presumption, according to which, in custody disputes involving children of "tender years,"[91] it is ordinarily in a child's best interests to have custody awarded to the parent who has spent the most time caring day to day for that child.[92]

Only three states adopted the primary caretaker presumption, and all three eventually replaced it with other approaches.[93] One criticism was that, while formally gender neutral, the primary caretaker presumption unfairly favored mothers.[94] A related reason for the fail-

87 *See id.* 979–80. Scholars have also suggested preventing custody trade-offs by making other subjects of divorce bargaining, such as marital property division and spousal support, more determinate. *See, e.g.*, Herma Hill Kay, *No-Fault Divorce and Child Custody: Chilling Out the Gender Wars*, 36 FAM. L.Q. 27, 42 (2002) (arguing that by making spousal support less discretionary, the rules proposed in the American Law Institute's 2002 Principles of the Law of Family Dissolution "lessen[ ] the incentive to use children as a bargaining chip").

88 Mnookin & Kornhauser, *supra* note 43, at 977–78.

89 278 S.E.2d 357 (W. Va. 1981).

90 *Id.* at 360.

91 *Id.* at 363.

92 *See id.* at 360, 362–63. *Garska* thus revived, in gender-neutral terms, the presumption of maternal custody for children of tender years that West Virginia courts had applied prior to state legislation mandating that custody be awarded on the basis of "the best interest of the children based upon the merits of each case" rather than on a presumption that "either the father or the mother should be awarded custody." *Id.* at 360.

93 *See* Katharine T. Bartlett, *U.S. Custody Law and Trends in the Context of the ALI Principles of the Law of Family Dissolution*, 10 VA. J. SOC. POL'Y & L. 5, 17 (2002); Barbara Bennett Woodhouse, *Child Custody in the Age of Children's Rights: The Search for a Just and Workable Standard*, 33 FAM. L.Q. 815, 822–23 (1999).

94 *See* Woodhouse, *supra* note 93, at 823.

ure of the primary caretaker presumption was the increasing popularity of the view, promoted initially by fathers'-rights advocates and later by some child-rearing experts as well, that children are better served by a close and continuing relationship with both parents than by the sole custody/visitation paradigm under which children spend the vast majority of time with one custodial parent.[95] While the best-interests assessment still typically determines how custody is allocated between the parents, some states have created a presumption of joint custody, and many others have revised their custody statutes to provide that courts assessing best interests should consider both the harm to children from disruption of the bond with a primary caretaker, and the benefit to children of maintaining a close and continuing relationship with both parents.[96]

Preventing trade-offs between custody and money was also a motivating factor behind a more recently proposed replacement of the best-interests standard: the ALI approximation rule, according to which custody is awarded in proportion to the amount of time each parent spent caring for the child during the intact relationship.[97] In promoting the approximation rule, Elizabeth Scott cited the literature arguing that the indeterminacy of the best-interests standard encourages custody-financial trade-offs.[98] The hope was that the approximation rule would be so determinate, and align so closely with the parties' preferences, that parents would settle rather than litigate custody. The only state to adopt the approximation rule, however, has been West Virginia, the same state that initially adopted the primary caretaker presumption.[99]

Presumably, proposals for more determinate substantive law have failed to gain traction in part because of a perception that something would be lost if courts were constrained not to consider other factors. The debate is thus an incarnation of the more general jurisprudential choice between rules and standards. Rules are necessarily overinclusive and underinclusive, and this must be balanced against the benefits of greater determinism. Any approach to increasing pre-

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95 *See, e.g.*, David L. Chambers, *Rethinking the Substantive Rules for Custody Disputes in Divorce*, 83 MICH. L. REV. 477, 550–57 (1984).

96 *See, e.g.*, FLA. STAT. ANN. § 61.13(2) (West Supp. 2017).

97 *See* PRINCIPLES OF THE LAW OF FAMILY DISSOLUTION: ANALYSIS AND RECOMMENDATIONS § 2.08 (AM. LAW INST. 2002).

98 *See* Scott, *supra* note 43, at 643–56.

99 W. VA. CODE ANN. § 48-9-206(a) (LexisNexis 2015); *see* Mary Jean Dolan & Daniel J. Hynan, *Fighting over Bedtime Stories: An Empirical Study of the Risks of Valuing Quantity over Quality in Child Custody Decisions*, 38 LAW & PSYCHOL. REV. 45, 56 (2014).

dictability by making the substantive law more rule-like invites the objection that relevant circumstances are ignored. Settlement bifurcation is compatible with either rules or standards and is thus a procedural alternative to deviating from what otherwise might be the optimal substantive-law approach.

2. Judicial Review

Another procedural mechanism for preventing custody trade-offs is judicial review. With respect to ensuring that trade-offs do not produce a custody arrangement adverse to children's interests, such a mechanism is already, nominally, in place: in most U.S. jurisdictions, parental custody settlements can only be enforced, or incorporated into a court order or judicial decree, if a judge determines the custody arrangement to be in the best interests of the child or children.[100] It is rare, however, for courts to reject parental custody agreements in the name of children's interests.[101] Moreover, it is difficult for courts to discern when custody has been traded for money, and agreements regarding marital property division and spousal support are typically binding upon the courts unless unconscionable or extremely unfair.[102] These problems with judicial review extend beyond the family law context. With any settlement that may affect third parties, judicial review is a potential solution, but it will always be difficult for judges to determine whether a settlement is unfair to unrepresented parties.

3. Changes in Terminology

In addition to replacing the best-interests-of-the-child standard with the more determinate approximation rule, the ALI sought to conceptually distinguish child-custody settlements from those concerning monetary issues by requiring parents to present their custody agreements in the form of a separate agreement labeled a "parenting plan."[103] A number of states now employ "parenting plan" or similar terminology to characterize custody settlements,[104] both to signal the goal of parental cooperation[105] and to encourage parents to work out a

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100 *See* Abramowicz, *supra* note 65, at 80–81.

101 *See id.* at 80; *see also, e.g.*, Mnookin & Kornhauser, *supra* note 43, at 993 ("Courts typically rubber stamp an agreement reached by the parties.").

102 *See* Penelope Eileen Bryan, *Women's Freedom to Contract at Divorce: A Mask for Contextual Coercion*, 47 BUFF. L. REV. 1153, 1238 (1999).

103 *See* Kay, *supra* note 87, at 41.

104 *See, e.g.*, MINN. STAT. ANN. § 518.1705 (West 2017); OR. REV. STAT. ANN. § 107.102 (West 2017).

105 *See* Marsha Garrison, *Promoting Cooperative Parenting: Programs and Prospects*, 9 J.L.

detailed custody arrangement that facilitates an ongoing relationship with both parents.[106]

Herma Hill Kay has characterized the ALI's change in terminology as attempting to "build a firewall" between custody agreements and agreements regarding financial aspects of divorce.[107] She acknowledges, though, that "one cannot put too much weight on this effort to build a firewall between the parenting plan and the financial negotiations; obviously, uneven bargains still can and probably will be struck."[108] Without a mechanism in place to prevent trade-offs between custody and property, jurisdictions can try to nudge parents toward isolating their negotiations regarding custody from their negotiations regarding the other incidents of divorce. They cannot, however, prevent such trade-offs altogether.

C. Bifurcating Custody Settlements

Bifurcating settlements can build a stronger "firewall" between custody settlements and other aspects of divorce negotiations without altering substantive child custody law in ways that might not otherwise be desirable. This section addresses the potential benefits and costs of bifurcating settlements in the context of child custody, how best to implement bifurcating settlements in this context, and complicating factors that are specific to family law but may shed light on other contexts as well.

The context of child-custody settlements makes clear how bifurcation can prevent trade-offs that harm third parties. Children are paradigmatic unrepresented third parties, deeply affected by their parents' agreements, but with no say in them.[109] This is especially the case for divorce settlements, which determine both where and with whom the children will live and how much money will be contributed to their support.[110] If parents could not make financial concessions in exchange for a desired custody arrangement, children would no longer

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& FAM. STUD. 265, 270 (2007) ("[S]ome states now use the term 'parenting plan' instead of 'custody and visitation' . . . to reduce the sense that there are custody 'winners' and 'losers' and thus to promote parental cooperation.").

106 *See id.*

107 Kay, *supra* note 87, at 41.

108 *Id.*

109 *Cf.* Sarah Abramowicz, *Beyond Family Law*, 63 CASE W. RES. L. REV. 293, 336 (2012) (noting that while children may be profoundly affected by parental contracts, outside of the family law context neither courts nor scholars consider how parental contracts affect children's interests).

110 While many jurisdictions permit or require courts to consider children's preferences in resolving custody disputes, courts typically are not required to allocate custody according to

suffer the diminished material well-being or the expressive harm that such trade-offs may inflict. Parents who forgo their custodial rights in such trade-offs would no longer be driven by financial incentives to accept a suboptimal custody arrangement, for instance one that detrimentally reduces the child's contact with a noncustodial parent. Meanwhile, if bifurcation can eliminate or reduce strategic threats to litigate custody, this may make the settlement process less adversarial and more cooperative, which commentators have linked to more harmonious coparenting postdivorce.[111]

The mechanism by which bifurcation reduces trade-offs is straightforward. Suppose divorcing parents would like to give a mother more custody than she could expect at trial in exchange for less money from the father. They might still attempt this even in a world of bifurcated settlement, but if custody is resolved first, the father might worry that after custody is resolved, the mother will renege on any financial promises.[112] If the father trusts the mother not to renege on an implicit deal, they might still make trade-offs, however. This is a more general limitation of bifurcated settlements; parties that trust each other may still make trade-offs.[113] Similarly, opposing lawyers might enter into implicit deals with one another, though the mother's lawyer would be duty bound to remind the mother that she is not bound by any implicit deal. In any event, the possibility that trust may allow evasion of bifurcated settlements does not argue against such a settlement regime. It merely shows that in some percentage of cases, where trust is sufficiently high, bifurcation will have neither significant costs nor significant benefits. Thus, a normative analysis of bifurcation must depend largely on the remaining cases in which parties do not trust one another sufficiently to thwart settlement bifurcation.

To appreciate the degree to which bifurcating settlements reduces custody-financial trade-offs, we must clarify the economic explanation for why such trade-offs exist. Some of the literature on child-custody negotiations worries about disparate bargaining power,[114] which is

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those preferences. *See* Barbara A. Atwood, *The Child's Voice in Custody Litigation: An Empirical Survey and Suggestions for Reform*, 45 ARIZ. L. REV. 629, 640 (2003).

111 *See, e.g.*, Scott, *supra* note 43, at 649 ("Anger and bitterness generated in conflictual negotiation or adjudication can poison the prospects of future cooperation between parents.").

112 *See* Altman, *supra* note 8, at 528 ("Even if one party obtained the custody agreement by agreeing to bad financial terms, she could now change her mind, and seek reasonable financial terms without fear of losing custody or visitation.").

113 *See supra* note 7 and accompanying text.

114 *See, e.g.*, Bryan, *supra* note 102, at 1180–91 (enumerating reasons that women are often

driven in part by asymmetric risk aversion.[115] The party that is more risk averse will generally be willing to make more concessions to the other party to avoid a trial. Some claim that women are more risk averse than men and that this affects women adversely in male-female custody negotiations.[116] But risk aversion by itself seems unlikely to lead to trade-offs between custody and financial issues. The party that is more risk averse would be expected to make greater concessions with respect to each issue, not necessarily to make trade-offs between issues.

But if parents have asymmetric preferences[117] with regard to two issues, trade-offs become more likely. Suppose, for example, that a mother cares much more about custody relative to money than a father. An extra increment in custody might be worth a sacrifice of $10,000 in income to the mother but only $1000 in income to the father. If that is so, then the parents are likely to trade custody for money. Moreover, while the trade-off maximizes the joint interests of the parents, it may seem unbalanced. We can rate settlements relative to the expected distribution of judicial decisions, characterizing a tenth-percentile outcome from the mother's perspective as one that she would expect to do better than 90% of the time. The mother might accept such an outcome for a sixtieth-percentile outcome on child custody, since she is willing to give up a relatively large amount of money for a small improvement in custody. If both parties cared much more about custody than money, this might seem like a balanced agreement (placing the child's interests aside), but the mother's hypothesized greater concern with custody leads to an unbalanced outcome.

Loss aversion may further contribute to trade-offs. The behavioral economics literature recognizes that what an actor experiences as a loss may matter a great deal more than what the actor experiences

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at a disadvantage in divorce negotiations with men, including lack of legal representation or inadequate legal representation, less aggressive styles of conflict resolution, and lesser status and education); Trina Grillo, *The Mediation Alternative: Process Dangers for Women*, 100 YALE L.J. 1545, 1601–05 (1991) (suggesting that the "ethic of care" may make women more conciliatory than men, putting women at a disadvantage in divorce and custody mediation).

115 *See* Mnookin & Kornhauser, *supra* note 43, at 979–80 (discussing how having relatively greater risk aversion than men can put women at a disadvantage in custody bargaining).

116 *See generally* Margaret F. Brinig, *Does Mediation Systematically Disadvantage Women?*, 2 WM. & MARY J. WOMEN & L. 1 (1995) (evaluating claim that women are disadvantaged in divorce negotiations because they are more risk averse than men).

117 *See generally* Brinig & Alexeev, *supra* note 44 (finding evidence of asymmetric preferences regarding custody).

as a gain.[118] Thus, a parent who has been the primary caregiver may be highly sensitive to the possibility of losing primary custody. Margaret Brinig and Michael Alexeev note that litigating custody may have greater "downside risk" for the primary caregiver.[119] Loss aversion interacts with asymmetric stakes: while loss aversion will affect how parents react to prospective losses in financial position, asymmetric stakes again may lead to compromises. Elizabeth Scott writes that "the psychological response of loss aversion combines with the realistic assessment of asymmetrical stakes in the outcome to reinforce the tendency of mothers facing adjudication under the best interests standard to settle out of court."[120] In other words, economic theory reinforces the unsurprising point that someone who is deeply connected to her child may be so concerned about a potential loss of custody that she sacrifices a great deal financially, even though that causes a loss too.

Bifurcation would not eliminate distortions in settlement attributable to loss aversion, but it would help ensure that asymmetric preferences do not lead to trade-offs. If a primary caregiver is loss averse with respect to any reduction in custody, then that caregiver might be especially resolved not to give up even a small amount of custody to the secondary caregiver. This could lead to litigation, or it could lead the other parent to agree to receiving less custody. On the other hand, a primary caregiver might not be so loss averse with respect to a small reduction in custody, but very loss averse with respect to the prospect of receiving only visitation. In this case, the primary caregiver would likely make greater concessions on custody than if trade-offs were permitted, and might be more likely to accept restrictions, such as agreeing not to relocate, as a condition of retaining custody. It is thus not clear how bifurcation would affect the allocation of custody, and, given the notorious difficulty of assessing children's best interests in the context of custody, even less clear whether the custody allocation produced by bifurcation would promote or work against those interests. What is clear is that the more involved parent would be less likely to accept a financial compromise adverse to the child's interests.

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118 *See, e.g.*, Daniel Kahneman et al., *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSP. 193, 193, 199 (1991).

119 *See* Brinig & Aleexev, *supra* note 44, at 288.

120 Scott, *supra* note 43, at 654.

1. *Costs of Bifurcation*

Bifurcating custody settlements from the financial aspects of divorce has at least two potential costs: first, preventing "good parents" from sacrificing their material well-being for the sake of obtaining a desired custody arrangement may lead to worse custody allocations; and second, bifurcation might increase litigation rates and worsen the settlement process. These costs would fall in part on children,[121] thus inflicting harm on the same third parties that bifurcating custody would seek to protect.

a. *The Solomonic Problem and Settlement Accuracy*

In the biblical story of custody adjudication, King Solomon was confronted with two women who both claimed to be the mother of the same infant.[122] Solomon decreed that because he could not determine which was the true mother, the baby would be cut in half and divided between the claimants accordingly. In response, one woman immediately cried out that King Solomon should award the child to the other rather than carry out his judgment. This reaction revealed the objector to be the true mother precisely because she was willing to sacrifice her own happiness for the sake of her child's well-being, and so King Solomon gave the child to her.[123]

Bifurcating custody settlements from financial ones creates the potential of what we will call "the Solomonic problem."[124] The Solomonic problem stems from the fact that, in the context of custody trade-offs, parental sacrifice can potentially help to produce the optimal custody allocation. Trade-offs play an informational function in that they enable parents to demonstrate the extent to which they value their children's custody. Trade-offs can at the same time help the parent who cares the most about custody, and thus is putatively the better parent, to obtain a greater share of custody. The Solomonic problem illustrates a significant potential downside of bifurcating settlements more generally: What if, by eliminating trade-offs, we reduce settlement accuracy? In the context of child custody, where the primary goal is promoting children's interests, we can define settlement

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121 Studies have found that litigating custody diminishes children's well-being by elevating parental conflict, reducing parental cooperation postdivorce, and increasing the likelihood of postdivorce litigation. *See* Scott, *supra* note 43, at 648–49.

122 1 *Kings* 3:16–28.

123 *Id.*

124 *Cf.* Garska v. McCoy, 278 S.E.2d 357, 362 (W. Va. 1981) (coining the term "Solomon syndrome" to characterize the "phenomenon . . . that the parent who is most attached to the child will be most willing to accept an inferior bargain").

accuracy as the settlement outcome that is most beneficial to the children whose custody is at issue. Eliminating trade-offs may improve children's material well-being. But this material benefit must be weighed against the possibility that bifurcation may affect negotiated custody outcomes in ways detrimental to children.

Of course, it is not inevitable that eliminating trade-offs would, in fact, affect negotiated arrangements to children's detriment. First, it is not clear that eliminating trade-offs would necessarily affect the custodial outcome. Empirical studies that have attempted to assess the presence and extent of custody trade-offs have found that custody settlements tend to remain stable when background custody entitlements change, and that what changes, if anything, is the financial settlement, as well as the extent of litigation.[125] This suggests that eliminating custody trade-offs may have no effect on custody outcomes, while potentially improving the financial position of primary custodial parents. Some commentators, moreover, have hypothesized that eliminating trade-offs would improve custody outcomes, as well as the settlement process. Elisabeth Scott, in advocating building a firewall between custody settlements and other aspects of divorce, has argued that where parents work out the details of custody without bringing in other aspects of the divorce settlement, they are less likely to engage in zero-sum bargaining and more likely to work cooperatively to come up with a custody arrangement that maximizes both parents' preferences as well as their children's interests.[126]

A related question is whether the possible effect on custody settlements of eliminating trade-offs would necessarily be detrimental to children. Even if the willingness to forgo money for custody indicates a greater desire for custody, a child will not always be better off with the parent who places a higher value on custody. Moreover, even if parental willingness to sacrifice financial well-being to obtain custody is a proxy for good parenting, this does not mean that a child will always benefit from spending more time with this "better" parent and less with the "worse" parent. The prevailing view is that children benefit by establishing a close and continuing relationship with both par-

125 *See* Brinig & Alexeev, *supra* note 44, at 283 (finding that "regardless of the legal rule, the outcomes in terms of ultimate child custody arrangements are very similar" and that "the difference appears in the share of wealth received by the divorcing wife or in her ability to receive long-term spousal support"); *see also* Brinig, *supra* note 45, at 806–07 (finding that introduction of legal standards more favorable to joint custody was followed by an increase in joint custody, but that this increase was consistent with earlier trends and "might have occurred even without the change in statute").

126 *See* Scott, *supra* note 43, at 644–52.

ents, and that the ideal custodial outcome will ensure sufficient contact to maintain or create such a relationship with both parents.[127] To the extent that eliminating trade-offs would increase time with noncustodial parents, this could be to children's benefit.

If, in fact, custody trade-offs produce the optimal custody outcome, then the question that follows is whether the detriment to children from a less beneficial custody arrangement (as a result of eliminating such trade-offs) is outweighed by the benefit to children of the greater financial security (to the extent that eliminating custody-money trade-offs would improve the financial well-being of children and custodial parents). The answer is likely no. The prevailing view of family law scholars and judges is that material wealth matters less to children's well-being than parental care and love.[128] Even moderate economic deprivation can adversely affect children. As long as a child's basic needs are met, however, the quality of the child's relationship with a parent, and the degree of emotional, psychological, and developmental well-being that this relationship produces for the child, is considered more important than material resources to the child's "best interests."[129]

The Solomonic problem may be specific to family law, but it illustrates a broader point with relevance to other potential applications of settlement bifurcation: if settlement succeeds in forcing independent negotiation of an issue, this will benefit third parties only on the assumption that the best outcome for third parties is the one that the negotiating parties would agree to in the absence of trade-offs.

b. Potential Adverse Effects on Settlement

Another possible downside of bifurcation is the potential to increase litigation rates. The context of child custody brings out a related, but distinct, possible downside: its effect on the settlement

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127 *See, e.g.*, MICH. COMP. LAWS ANN. § 722.23(j) (West Supp. 2017) (providing that custody courts assessing children's best interests must consider, inter alia, "[t]he willingness and ability of each of the parties to facilitate and encourage a close and continuing parent-child relationship between the child and the other parent or the child and the parents"); Solangel Maldonado, *Beyond Economic Fatherhood: Encouraging Divorced Fathers to Parent*, 153 U. PA. L. REV. 921, 949–60 (2005) (describing educational, psychological, and emotional benefits to children of greater engagement by divorced fathers).

128 *See* Burchard v. Garay, 724 P.2d 486, 491 (Cal. 1986) (in bank) ("[T]here is no basis for assuming a correlation between wealth and good parenting or wealth and happiness." (alteration in original) (quoting Ramsay Laing Klaff, *The Tender Years Doctrine: A Defense*, 70 CALIF. L. REV. 335, 350 (1982))); Carolyn J. Frantz, Note, *Eliminating Consideration of Parental Wealth in Post-Divorce Child Custody Disputes*, 99 MICH. L. REV. 216 (2000) (collecting sources).

129 *See* sources cited *supra* note 128.

process itself. Where a custody settlement is reached, but is preceded by a drawn-out and adversarial negotiation, the emotional and relational costs to the parties and their children are similar to those of litigation.[130] The relational costs of an adversarial settlement process are potentially relevant in any settlements where, as in child custody, the parties will have a continuing, long-term relationship even after the settlement ends, such that they benefit from a settlement process that facilitates cooperation and trust.[131]

The economic model of Part I showed that when litigation costs are especially high, bifurcation will tend to *reduce* litigation.[132] Indeed, the divorce context can provide some intuition underlying the model. Litigation costs may be high in divorce proceedings, especially if the emotional costs of such litigation are factored in. Once child custody is resolved, then only financial issues will be in play, and the cost of litigating those issues will be very high relative to the stakes. Thus, financial issues, once isolated, are quite likely to be settled. Anticipating this increases the payoff to resolving child custody. Even though under bifurcation two settlements must be reached in a divorce case instead of one, the stakes of each settlement will be lower than if parties were simultaneously negotiating a single settlement encompassing both child custody and financial issues. With sufficiently high litigation costs, two moderate-stakes settlements will be easier to achieve than a single high-stakes settlement. Nonetheless, as long as trade-offs between issues remains possible, it is unlikely that the parties will voluntarily decide issues seriatim.

This model assumes rational actors and assumes away psychological complications. Parties act strategically in divorce litigation, and so we believe this model has considerable resonance even in the divorce context. The divorce context, however, highlights other considerations that may push in the opposite direction. In the emotionally fraught context of divorce, trade-offs between custody and other terms of a divorce settlement could play a positive emotional role in ways that would increase parental satisfaction with settlements and reduce litigation rates. Were bifurcation to preclude such trade-offs, we could predict that the result in such cases might be an increase in litigation rates.

Consider, for instance, a parent who feels betrayed by and bitter about the divorce, and has a psychological need to win some aspect of

130 *See* Scott, *supra* note 43, at 649.

131 *See id.* at 648.

132 *See supra* Part I.

the divorce settlement.[133] Where trade-offs are available, such a parent might be satisfied by an arrangement in which he secures a slightly more advantageous financial arrangement implicitly or explicitly in exchange for not demanding a greater share of custodial time. This slight victory might fill the parent's need to feel that he was not completely taken advantage of in the divorce settlement. Absent the option of trade-offs, it is possible that such a parent, unable to obtain even a small advantage over the other parent, might feel emotionally driven to litigate instead of settling.[134] We acknowledge that this account is speculative, but our point is simply to illustrate that the economic model does not take into account all relevant psychological factors.

A related issue that our model in Part I does not address is the effect of bifurcating settlements on the duration and tenor of the settlement process itself. Encouraging parents to work out a custody arrangement in isolation from other issues may ameliorate the settlement process by making it more cooperative and child centered. On the other hand, it is also possible that bifurcation could make custody settlements more adversarial and costly. Bifurcation would increase the number of times that parents must appear before a judge—first to gain approval of the custody settlement, and later to gain approval of their settlement on other issues stemming from the divorce. Relatedly, by breaking the settlement process into stages, bifurcation may prolong the complexity and duration of the settlement process, which in turn could exacerbate the emotional turmoil of the divorce as well as increase legal fees. It is difficult, of course, to weigh these considerations against the benefits of settlement bifurcation. The analysis, in any event, highlights that the benefits of settlement bifurcation may be reduced in litigation in which emotion plays a relatively large role.

2. Obstacles to Bifurcation

Some issues specific to family law might complicate the implementation of bifurcation. By addressing some of these issues, we can

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133 *Cf.* JUNE CARBONE, FROM PARTNERS TO PARENTS: THE SECOND REVOLUTION IN FAMILY LAW 193 (2000) ("Custody battles have become ground zero in the gender wars because they are among the few remaining family law disputes where courts judge adult behavior.").

134 A number of commentators have noted the role of spite, anger, and similar emotions in child-custody bargaining. *See* Altman, *supra* note 8, at 529 ("The strength of spite and anger as motives should not be ignored."); Mnookin & Kornhauser, *supra* note 43, at 974 (acknowledging that parents might decide to litigate custody rather than settle out of spite and a desire to punish); Scott, *supra* note 43, at 646–47 ("[S]pite . . . is a familiar aspect of divorce negotiations.").

consider some of the complexities of real-world settlement and litigation that any attempt to bifurcate will implicate.

a. De Facto Trade-Offs

Perhaps the greatest obstacle to bifurcating settlements in the custody context is that there is nothing to prevent parents from making de facto trade-offs down the road. A parent intent on making trade-offs could always request a greater amount of custody than he desires, either at settlement or at trial, and then, once the court proceedings are concluded, offer to relinquish actual custody in exchange for financial compensation from the other parent. The law could, of course, prevent a formal modification of the settlement. Still, courts have no mechanism for policing divorced parents' day-to-day arrangements. More generally, when negotiating parties engage in repeated interactions following settlement, there may be opportunities for the parties to make trade-offs unmonitored by the court.

An additional complication in child custody is that nominal custody can be used to avoid child-support obligations. Child support is typically paid by the noncustodial parent to the custodial parent, with deductions for the amount of time that the child spends with the noncustodial parent.[135] When a parent declines to exercise the full extent of visitation that he has been allocated, but receives a deduction in support obligations on the basis of that allocation, the custodial parent receives less child support than she should be entitled to on the basis of the de facto custodial arrangement.[136] The custodial parent may nonetheless refrain from requesting additional support, either because she does not want to provide the noncustodial parent with the incentive to fully exercise his rights to parenting time, or because she lacks the resources to request a modification of child support consistent with the de facto arrangement.[137] Nominal custody would likely have an expanded role in a bifurcation regime because it allows ex post

135 *See* Sanford L. Braver et al., *Public Sentiments About the Parenting Time Adjustment in Child Support Awards*, 49 FAM. L.Q. 433, 434–35 (2015) (surveying approaches to child-support adjustments on the basis of time spent with the noncustodial parent).

136 *See* Altman, *supra* note 8, at 519 ("[I]t is often said that . . . noncustodial parents seek substantial visitation in order to reduce their child support obligations, and then do not even exercise their visitation rights."). The flip side of this problem is that primary custodial parents will at times refuse visitation to noncustodial parents who are delinquent in paying support. Although fulfillment of support obligations is supposed to be decoupled from visitation rights, this form of self-help is similarly difficult to prevent. *See* Mnookin & Kornhauser, *supra* note 43, at 964–66.

137 *See, e.g.*, Karen Syma Czapanskiy, *The Shared Custody Child Support Adjustment: Not Worth the Candle*, 49 FAM. L.Q. 409, 426–28 (2015).

custody-financial trade-offs that substitute for ex ante negotiated ones.

b. Modifiability of Custody Arrangements

Custody arrangements can be modified at any time until a child reaches the age of majority. There typically needs to be some sort of change in the child's circumstances to justify consideration of modification,[138] but even the inevitable fact of the child maturing has been found to constitute such a change.[139] For example, developmental problems a child experiences may prompt such consideration.[140] Most jurisdictions have held that parents cannot by agreement govern or eliminate future modifications to custody.[141]

In the absence of bifurcated settlements, the modifiability of custody arrangements may discourage trade-offs. Were a parent to trade custody for money, this would do nothing to prevent the parent who agreed to relinquish custody from later bringing a motion to modify custody. Thus, the parent who relinquished marital property or support in exchange for custody could possibly lose custody nonetheless, in the context of modification.

At the same time, modifiability may make it difficult to completely bifurcate custody from other issues. Even once parents have agreed to a custody arrangement, the potential threat of modification remains. Scott Altman has observed that parents negotiating financial terms after resolving custody might feel pressured to make concessions rather than risk provoking a future modification request.[142] Altman proposes for this reason that bifurcation be accompanied by making modification more difficult to obtain.[143] On the other hand,

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138 The majority of states require a showing of a substantial change in circumstances affecting the child's welfare in order for a court to consider whether the child's best interests require a change in custody. *See, e.g.*, OR. REV. STAT. § 107.135(1) (2015); WASH. REV. CODE ANN. § 26.09.260(1) (West 2017). Some states, however, do not require such a showing, allowing modification upon a showing that a change in custody is in the child's best interests. *See, e.g.*, NEV. REV. STAT. ANN. § 125.510(1) (LexisNexis 2010).

139 *See, e.g.*, Morales v. Lincoln, 367 S.W.3d 174, 179 (Mo. Ct. App. 2012) (finding child's entry into kindergarten constituted a change in circumstances sufficient to modify joint custody arrangement).

140 *See, e.g.*, Brewer v. Whitney, 666 N.Y.S.2d 354, 355 (App. Div. 1997) (finding change in circumstances sufficient to change from joint to sole custody where father better equipped to handle child's newly diagnosed speech and developmental delays).

141 *See* Abramowicz, *supra* note 65, at 85–88.

142 *See* Altman, *supra* note 8, at 528.

143 *See id.*

giving in to financial demands would not remove the risk of a future modification request.

While making modification more difficult to obtain might help to more completely sever custody settlements from settlements regarding other terms, bifurcation would nonetheless provide its intended benefit of reducing trade-offs even under current modification standards. Most current custody modification standards favor continuing the status quo, such that the initial custody allocation is a powerful buffer against modification.[144] A parent who has already negotiated and finalized a desired custody allocation should feel more comfortable about negotiating financial terms without risking loss of custody than if custody and financial terms were negotiated together.[145]

3. Design of Bifurcation

A potential argument against bifurcation is that it is impractical because issues are intertwined. Divorce settlements have been described as entailing a "mosaic" of closely related issues, many of which cannot be considered in isolation from the rest.[146] Matters of marital property division, spousal support, and, most obviously, child support are often contingent on custody outcomes.[147] When a parent is awarded primary custody, this may affect whether that parent is awarded the marital home (so that the children can continue living there), as well as how much marital property each parent is entitled to. Spousal support may sometimes be awarded on the basis that a parent will stay home to take care of young children, so it would be difficult to determine the proper amount of spousal support without

144 *See, e.g.*, OR. REV. STAT. § 107.135(1) (2015) (requiring a showing of a substantial change in circumstances affecting the child's welfare in order for a court to consider modifying custody). The preference for the status quo is reinforced by the best-interests standard that the court applies once a change in circumstances has been established; in most jurisdictions, either statute or caselaw dictate that it is typically in a child's best interest to maintain continuity. *See, e.g.*, *id.* § 107.137(1)(c) (directing courts assessing best interests to factor in "[t]he desirability of continuing an existing relationship"); Deyo v. Deyo, 658 N.Y.S.2d 153, 155 (App. Div. 1997) (describing "the general preference for maintaining stability by continuing the existing residential arrangement when appropriate").

145 Moreover, where custody settlements are bifurcated, trade-offs would be less likely to shape the original custody allocation than under the current approach, where custody and other terms are settled in the aggregate.

146 *See* Taff v. Bettcher, 703 A.2d 759, 760 n.2 (Conn. 1997) ("[O]rders relating to custody and support are part of a carefully crafted mosaic such that a change to one will necessarily create a change to the other.").

147 *See In re* Marriage of Jordan, 203 N.W.2d 314, 316 (Iowa 1972) (finding that property settlement and child support were "influenced considerably by the award of custody").

first knowing the custody outcome.[148] And, under the federally mandated child-support guidelines in place in all states,[149] child support is directly contingent on the allocation of custody.

The most straightforward design is thus seriatim bifurcation with custody settled first, followed by settlement of marital property, spousal support, and child support. This way, custody could be determined before the issues that tend to be contingent on custody. We suspect that this is the best approach to bifurcation on balance, but it is important to recognize arguments for alternatives. One alternative would be to decide financial issues first. A benefit to this is that financial issues will often be easier to resolve. The parties may have a better chance of resolving custody issues if they know that such resolution will definitively resolve the divorce proceedings. To enable financial issues to be resolved first, the financial agreement could include terms contingent upon different possible custody outcomes.

Another alternative is severable settlements. Parties would negotiate child custody and financial issues simultaneously, but either party would be able to back out of either portion of the settlement. The disadvantage of severable settlements is that interdependencies between provisions must be resolved. Severable settlements have two advantages over seriatim bifurcated settlements, however. First, severable settlements may reduce the number of court appearances to just one.[150] In most cases, neither party will back out of an agreed-upon settlement. That does not mean that bifurcation is irrelevant. The prospect that the other party might back out will tend to reduce trade-offs in the initial agreement, so actually exercising the power to back out of a portion of a settlement is not necessary. Second, each party must trust the other to evade the severable settlements regime because either party may defect from the strategy of cooperation, whereas seriatim bifurcated settlements can be evaded even where trust only runs one way.[151] Suppose, for example, that the parties would like to make a trade-off where a husband receives more money and a wife receives more custody than a court would be expected to award. If custody is negotiated first, then the parties will be able to negotiate this trade-off if the husband trusts the wife to stick to a fi-

148 *See, e.g.*, OHIO REV. CODE ANN. § 3105.18(C)(1)(f) (West 2017) (providing that a court awarding spousal support must consider, inter alia, "[t]he extent to which it would be inappropriate for a party, because that party will be custodian of a minor child of the marriage, to seek employment outside the home").

149 *See* 42 U.S.C. § 667(a) (2012) (mandating state adoption of child-support guidelines).

150 *See supra* Section II.C.

151 *See supra* Section II.C.

nancial deal. But with severable settlements, parties will be willing to risk a trade-off only if each party trusts the other not to renege.

Especially with severable settlements, though also with seriatim bifurcated settlements, the court should, prior to approving a custody agreement, ensure to its satisfaction that each parent understands the bifurcation mechanism. With severable settlements, the court should stress that regardless of the position of the attorneys, each party retains the ability to back out of either part of the agreement by notifying the court confidentially by a set date. With seriatim bifurcation, meanwhile, parents might negotiate other issues at the same time that they negotiate custody, but they could not be bound by such agreements until after determination of custody (or financial issues, if those are to be resolved first). The possibility of an asymmetry in legal information and representation makes it critical that the court verify parties' understanding; otherwise, one party could easily take advantage of the other's ignorance.

III. Protecting Third Parties' Financial Interests

Negotiating litigants will structure settlements to benefit themselves at third parties' expense. Even if mutually antagonistic, both parties can profit from settlements that reallocate value from third parties to one party because the other party can share in the benefit through some other concession. This Part describes situations in which bifurcation might combat such value extraction. Our primary contribution is not the idea of bifurcating settlements in these areas. Indeed, for several of these potential applications, at least one scholar has noted or suggested the possibility of bifurcating settlements. Strikingly, though, the possibility of bifurcation has been mentioned only in passing and usually quickly dismissed. We suspect that settlement bifurcation has received so little attention in these contexts because it is alien to our legal culture. Scholars and courts have thus devoted far more attention to substantive-law workarounds that address third-party effects indirectly. Our primary contribution in this Part is to make settlement bifurcation seem less strange by treating together what might initially seem like unrelated problems. By classifying value extraction from negotiated third-party settlements as a general problem and identifying settlement bifurcation as a solution, we identify at least one context in which settlement bifurcation does not seem to have received any consideration.[152] Meanwhile, by taking settlement

152 *See infra* Section III.A.

bifurcation seriously, we identify a wider range of benefits and costs to bifurcation in particular contexts than prior commentators have considered.

A. Protecting the Government: Punitive vs. Compensatory Damages

When entering into pretrial settlements in tort cases involving physical injuries, plaintiffs and defendants have strong incentives to characterize any damages that they agree to as compensatory rather than as punitive. Under the Internal Revenue Code, plaintiffs who are physically injured may exclude compensatory damages from gross income.[153] Meanwhile, defendants may deduct both compensatory and punitive damages.[154] Payments of compensatory damages thus reduce the government's tax receipts, while payments of punitive damages are revenue neutral, assuming that the parties have the same marginal tax rate.

This asymmetric tax treatment means that given any deal that would characterize some damages as punitive, the parties can always benefit by recharacterizing the damages as compensatory. Suppose the plaintiff pays taxes at a 20% marginal rate and that the parties both valued the claim at $1,000,000, believing (with certainty, to keep the example simple[155]) that the jury would find $500,000 in compensatory damages and $500,000 in punitive damages. Assuming the courts will defer to the parties' characterization of the damages, as they generally do,[156] the parties would anticipate that an agreement honestly characterizing damages payments as equally divided between compen-

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153 I.R.C. § 104(a)(2) (2012).

154 *See* Rev. Rul. 80-211, 1980-2 C.B. 57, 1980 WL 130077. *See generally* Kimberly A. Pace, *The Tax Deductibility of Punitive Damage Payments: Who Should Ultimately Bear the Burden for Corporate Misconduct?*, 47 ALA. L. REV. 825 (1996) (arguing against the current treatment of punitive damages).

155 The analysis would be the same if the parties both expected a 50% chance of $1,000,000 in compensatory damages and $1,000,000 in punitive damages, or a 100% chance of $500,000 in compensatory damages and a 10% chance of $5,000,000 in punitive damages.

156 Byrne v. Comm'r, 90 T.C. 1000, 1007 (1988) ("[T]he most important fact in determining the purpose of the payment is 'express language [in the agreement] stating that the payment was (or was not) made on account of personal injury.'" (alteration in original) (quoting Metzger v. Comm'r, 88 T.C. 834, 847 (1987))). *But see* M. Sean Sullivan, Comment, *Achieving the Best Tax Treatment for Your Physical Injury Client's Settlement Award*, 66 MISS. L.J. 579, 587 (1997) (citing Robinson v. Comm'r, 102 T.C. 116 (1994), *aff'd in part, rev'd in part*, 70 F.3d 34 (5th Cir. 1995)) ("[A] court will in proper circumstances disregard the terms of the agreement and allocate the damages on its own.").

satory and punitive damages would lead the plaintiff to pay $100,000 in taxes.[157]

In contrast, a settlement agreement characterizing the $1,000,000 payment entirely as compensatory damages for physical injury would benefit the plaintiff and leave the defendant no worse off. Similarly, a settlement agreement for $900,000, characterized entirely as compensatory damages, would benefit the defendant while leaving the plaintiff no worse off. Thus, if $1,000,000 would have been the settlement value in a world without taxes, the parties will likely agree to a settlement value somewhere between $900,000 and $1,000,000, perhaps at $950,000,[158] characterized entirely as compensatory damages. Unsurprisingly, given this calculus, leading attorneys report that they never specifically allocate any portion of damages to punitive damages in settlement agreements.[159] Insurance generally does not cover punitive damages,[160] providing a further basis to characterize damages as compensatory rather than punitive.

Much of the scholarly debate has focused on whether the deductibility of punitive damages interferes with the objectives of tort law. In the leading article on this topic, Gregg Polsky and Dan Markel noted that because juries making punitive damage determinations often assume that punitive damages are not deductible, or fail to take this issue directly into account, "the true cost of a punitive damages award is often substantially less than the nominal amount of the award."[161] This has led some policymakers to argue for making punitive damages nondeductible.[162] Polsky and Markel defend the alternative policy of making jurors aware of the tax implications of the deductibility of punitive damages.[163] Central to Polsky and Markel's argument is that defendants could circumvent a nondeductibility rule by entering into

157 The $500,000 in compensatory damages would be untaxed, and 20% of the remaining $500,000 in punitive damages is $100,000.

158 The literature often assumes that parties settle at the midpoint of the settlement range. *See, e.g.*, Samuel Issacharoff & George Loewenstein, *Second Thoughts About Summary Judgment*, 100 YALE L.J. 73, 98 (1990).

159 *See* Tom Baker, *Transforming Punishment into Compensation: In the Shadow of Punitive Damages*, 1998 WIS. L. REV. 211, 218 (reporting the result of interviews with personal injury lawyers in which none of the interviewees had settled "a case for an amount that included a portion identified as 'punitive damages'"); Gregg D. Polsky & Dan Markel, *Taxing Punitive Damages*, 96 VA. L. REV. 1295, 1334 (2010) ("[S]ettlement agreements routinely and expressly allocate the entire amount to compensatory damages.").

160 *Cf.* Catherine M. Sharkey, *Revisiting the Noninsurable Costs of Accidents*, 64 MD. L. REV. 409, 413, 452 (2005) (proposing to allow insurability of some punitive damages).

161 Polsky & Markel, *supra* note 159, at 1297.

162 *Id.* at 1298–99 & n.5 (collecting sources).

163 *Id.* at 1299, 1302–24.

settlements that would recharacterize punitive damages as compensatory.[164] If jurors were aware of the nondeductibility of punitive damages and were to "gross up" damages awards as a result, then settlement negotiations would take into account this anticipated increase in damages, and the goals of tort law would be met even in cases that are settled.[165]

This policy recommendation may improve the legal system's ability to achieve its tort goals, but it fails to advance the government's tax policy goals. Settling parties would continue to characterize damages as compensatory rather than punitive, and those damages would thus be deductible to the defendant and yet excludable from the plaintiff's income. The increase in the damages award designed to counteract deductibility would redound to the plaintiff, rather than to the government. Unless plaintiffs have inadequate incentives to bring punitive damages claims, this produces a windfall.[166] Meanwhile, if the alternative policy were adopted in which punitive damages were made nondeductible, then the parties would have an even greater incentive to characterize damages as compensatory (though because they have plenty enough incentive already, this would not make things substantially worse). And if we assume that, absent implementation concerns, punitive damages in theory ought to be taxable, then making punitive damages nondeductible will not have the desired effect in settled cases.

If it were possible to induce the parties to divide any agreed-upon damages honestly into the compensatory and punitive categories, based on the parties' expected value of compensatory and punitive damages, then the legal system would have flexibility to achieve both its tort and tax goals. If punitive damages properly should be nondeductible, then a simple policy change could accomplish the goal, because Polsky and Markel's concerns about recharacterization of punitive damages as compensatory would vanish with an honest breakdown. If punitive damages properly should be deductible, as they are now, then it might well make sense to adopt the Polsky-Markel approach of instructing juries to increase the punitive damages award based on tax concerns, thus improving optimization of the tort system. The government would still be able to tax the punitive dam-

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164 *Id.* at 1296 ("[D]efendants could easily circumvent the nondeductibility rule by disguising punitive damages as compensatory damages . . . .").

165 *Id.* at 1304, 1307.

166 *See* Catherine M. Sharkey, *Punitive Damages as Societal Damages*, 113 YALE L.J. 347, 370 (2003).

ages. Indeed, if the parties further honestly broke down punitive damages based on their anticipation of the tax gross up, the government could decide to tax the gross-up portion of punitive damages (that is, the portion designed to ensure that the defendant does not benefit from deductibility) at a higher rate to minimize the plaintiff's windfall from the gross up.

The literature's focus on incomplete solutions to the punitive damages taxation problem reveals that commentators assume that parties will continue to be able to recharacterize punitive damages as compensatory. The same assumption can be seen in the literature on whether plaintiffs should be required to turn over a large portion of punitive damages to the government. Some commentators have argued that punitive damages claims produce a windfall even if taxed at ordinary rates, and so plaintiffs should be permitted to keep only some small percentage of punitive damage awards.[167] The result would be similar to whistleblower suits, such as those under the False Claims Act,[168] where the prevailing plaintiff keeps a small percentage of damages and the government keeps the rest. Parties could evade such a rule by characterizing damages as compensatory, just as they already do now.

The assumption that parties can reallocate compensatory and punitive damages reflects that no one has considered whether there might be some means of distinguishing the compensatory and punitive portions of negotiated damages. But bifurcated or severable settlements could resolve this issue easily. The simplest approach is to have the parties negotiate compensatory damages first and punitive damages second. If the settlement is submitted to a court,[169] then the court would insist that it approve the compensatory damages award before the punitive damages award. In this case, the court would not honor an agreement on punitive damages unless it were dated after the court's approval of the compensatory damages. Of course, this can work without court supervision as well. All that is required is that the punitive damages agreement be signed later than the compensatory damages agreement. If there is a concern that the attorneys cannot be

167 *See, e.g.*, Andrew F. Daughety & Jennifer F. Reinganum, *Found Money? Split-Award Statutes and Settlement of Punitive Damages Cases*, 5 AM. L. & ECON. REV. 134, 158–59 (2003).

168 31 U.S.C. §§ 3729–3733 (2012).

169 Under existing law, judicial approval of settlements is not generally required. *See generally* Sanford I. Weisburst, *Judicial Review of Settlements and Consent Decrees: An Economic Analysis*, 28 J. LEGAL STUD. 55 (1999) (providing an economic theory of when judicial approval is and is not required).

trusted to date their agreements properly,[170] further precautions could be added, such as a requirement that settlement agreements be notarized, or a requirement that the parties themselves sign a document attesting that they have previously agreed to compensatory damages and understand that they may choose not to sign an agreement on punitive damages. A waiting period of, say, one month also might be used to thwart joint negotiations.

This approach makes it harder for the parties to trade compensatory for punitive damages. Suppose, as in the example above, that it were in the mutual interest of the parties to agree to a judgment for $950,000 in compensatory damages with no punitive damages, even though the parties believed that the expected value for compensatory and punitive damages would be $500,000 each. Assuming the parties do not trust each other, the defendant would not be willing to agree to compensatory damages of $950,000 because it would worry that after that agreement were reached, the plaintiff would continue to trial on the punitive damages claim. If punitive damages were first, the plaintiff would not agree to $0 in punitive damages because then the defendant would have no reason to agree to pay $950,000 in compensatory damages later. Thus, the parties will generally negotiate compensatory damages based on their actual expectation of such damages, also taking into account considerations of litigation cost and other variables affecting their relative bargaining power. If an agreement on compensatory damages were reached, the parties would then negotiate punitive damages. They might well negotiate both simultaneously, of course, but the defendant would only agree to the compensatory damages award if it thought the agreement was based on the expectation of those damages.

It might seem that the parties could easily evade the settlement bifurcation system by agreeing to both compensatory and punitive damages in advance. The defendant, however, would be willing to agree to the $950,000 compensatory award only if it trusted the plaintiff not to renege on any implicit deal.[171] The bifurcation of settlements rules out an explicit deal. But this seems unlikely, at least in the typical tort case. The parties are not repeat players, and the legal system would be structured to *encourage* plaintiffs in this situation to renege on any implicit agreement. The lawyers are repeat players, but

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170 It is unethical for lawyers to backdate documents to countermand a legal requirement. *See* Jeffrey L. Kwall & Stuart Duhl, *Backdating*, 63 BUS. LAW. 1153, 1157–59 (2008). Presumably, it would also be unethical to postdate a document.

171 *See supra* note 7 and accompanying text.

their duty is to their clients, and so, for example, the plaintiff's lawyers would be duty bound to explain to the plaintiff that it could choose *not* to follow through on an agreement on punitive damages that is not in its ex post interest.[172] It would generally be in the lawyers' interest to point this out anyway, whether the lawyers are paid by the hour or on contingency. There is thus at least a substantial chance that the plaintiff or defendant would renege on any implicit deal that trades off punitive for compensatory damages.

The goal of a settlement bifurcation system is not to thwart settlement, but to ensure that the parties will settle the different issues separately. Ordinarily, it seems likely that the parties will reach settlements on both issues and these settlements will be stable in the sense that neither party has an incentive to back out. But in designing the system, we must plan for the possibility that the parties will sometimes agree on one component of damages without agreeing on the other. What should the court do if the parties agree on compensatory damages but fail to agree on punitive damages? In this case, there would still be a trial and, critically, the defendant would still be able to contest liability. A jury ideally would not be informed of the amount of the compensatory damages in the settlement, and a judge acting as factfinder would be encouraged to ignore this information.[173] A jury might be instructed not to render a compensatory damages award, because the parties have agreed to that, but would still consider punitive damages. If that seems awkward, for example because punitive damages and compensatory damages are linked,[174] the jury might produce a full verdict, potentially without even being informed of the compensatory damages settlement. But any compensatory award would be disregarded in favor of the negotiated compensatory award.

It might seem that it would make more sense at the trial to instruct the jury that the parties have already agreed that liability is conceded and that their only task is to determine the amount of punitive damages. Perhaps it would also seem then that the jury should even be

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172 Comprehensive settlements already present lawyers with duties to ensure that clients have provided informed consent. *See* Howard M. Erichson, *The Trouble with All-or-Nothing Settlements*, 58 U. KAN. L. REV. 979, 1017–20 (2010).

173 This may not be easy to do. *See generally* Andrew J. Wistrich et al., *Can Judges Ignore Inadmissible Information? The Difficulty of Deliberately Disregarding*, 153 U. PA. L. REV. 1251 (2005) (concluding that it is generally not easy for judges to avoid being influenced by inadmissible, yet relevant, information of which they become aware).

174 *See, e.g.*, Philip Morris USA v. Williams, 549 U.S. 346, 351 (2007) (finding that punitive damages are more likely to meet due process requirements when they are less than ten times compensatory damages).

informed of the compensatory damages as an anchor on the punitive damages. The problem with this approach is that the negotiating parties would then recognize that any settlement of compensatory damages would be viewed as an admission of liability, thus increasing the chance of a substantial judgment on punitive damages.[175] This could make negotiation on compensatory damages considerably more difficult. Even if the parties agreed, for example, that there is a 50% chance of liability, the defendant would hesitate to agree to a settlement for 50% of anticipated compensatory damages because that would worsen the defendant's position on punitive damages. Thus, to ensure that the parties negotiate each damages component based on its expected value, a trial on just one portion of the damages must still consider whether liability is appropriate.

This approach may seem awkward given the linkage between compensatory and punitive damages. A claim for compensatory damages and a claim for punitive damages are not independent; ordinarily, one cannot receive the latter without the former.[176] Moreover, courts review punitive damages in part by considering the ratio of punitive to compensatory damages.[177] They do this only in cases in which a jury has already found liability, so there is no need to worry that the damages are being discounted. If a partial settlement of compensatory damages reflects a discount for uncertain liability, this may prevent the court from determining the true ratio in the exercise of its power of judicial review.

A possible solution would be for the parties to negotiate punitive damages *first*. This may seem to put the cart before the horse, but there would be no need for judicial review of the punitive damages. Moreover, the jury instructions would be straightforward; the punitive

175 *See* Victor E. Schwartz & Christopher E. Appel, *Putting the Cart Before the Horse: The Prejudicial Practice of a "Reverse Bifurcation" Approach to Punitive Damages*, 2 CHARLESTON L. REV. 375, 380–81 (2008).

176 *But see, e.g.*, Abner v. Kan. City S. R.R. Co., 513 F.3d 154, 165 (5th Cir. 2008) (allowing punitive damages even absent a finding of compensatory damages). The Due Process Clause does prevent states from using punitive damages to punish a defendant for injuries to nonparties. *See Williams*, 549 U.S. at 346; *see also* Thomas B. Colby, *Clearing the Smoke from* Philip Morris v. Williams*: The Past, Present, and Future of Punitive Damages*, 118 YALE L.J. 392 (2008) (exploring the implications of this holding and arguing that using punitive damages as punishment for public wrong substitutes for the criminal law and thus violates the Constitution).

177 *See, e.g.*, State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 425 (2003) ("Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process."); BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 580–83 (1996) (finding a punitive-compensatory damages ratio of 500 to be beyond the constitutionally acceptable range).

damages instructions would simply be excluded, as the jury would need to calculate only compensatory damages. This is an example of how order of bifurcated settlements may matter, and why it might make sense to bifurcate settlements rather than allow parties to enter into severable settlements, where it will not be possible to predict which issue might be resolved before a trial.

A variation on this approach would require the parties to negotiate not the amount of punitive damages, but the punitive damages multiplier itself. For example, suppose that the parties negotiated a multiplier of 5.0, but then failed to negotiate a compensatory damages amount. A jury would be asked to determine compensatory damages only, and perhaps even explicitly instructed that punitive damages are not available in this proceeding. The punitive damages would then be calculated based on the earlier agreed-upon ratio. This would further facilitate judicial review of punitive damages because a ratio would be negotiated against the backdrop of Supreme Court caselaw on what is permissible.[178] Scholars have suggested that factfinders might be asked to announce a multiplier rather than a specific damages amount,[179] and this approach to bifurcation simply extends this into the settlement arena.

B. Protecting Consumers: Damages vs. Market Exclusion

Reverse payment settlements under the Hatch-Waxman Act[180] provide another useful illustration of how settling parties may make trade-offs to the detriment of third parties, in this case private rather than governmental third parties. A goal of the statute was to encourage generic-drug companies to challenge the validity of patents protecting brand-name drugs.[181] Patent litigation is expensive, and a potential generic-drug manufacturer has little incentive to enter a market if winning would simply mean that the market immediately becomes open to all generic-drug manufacturers, driving the price of such drugs down to marginal cost. Congress thus provided that the

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178 *See* cases cited *supra* note 177.

179 *See, e.g.*, Sarah G. Cronan & J. Brittany Cross, *Predictability in Punitive Damages: Considering the Use of Punitive Damage Multipliers*, 79 DEF. COUNS. J. 454, 454 (2012) ("Rather than awarding a single punitive damage award in each case, under the multiplier approach, a jury sets a mathematical relationship between punitive and compensatory damages by establishing a dollar-for-dollar ratio . . . .").

180 Drug Price Competition and Patent Term Restoration Act of 1984, Pub. L. No. 98-417, 98 Stat. 1585 (codified as amended in scattered sections of the U.S. Code).

181 *See* Colleen Kelly, *The Balance Between Innovation and Competition: The Hatch-Waxman Act, the 2003 Amendments, and Beyond*, 66 FOOD & DRUG L.J. 417, 424–25 (2011).

first generic company to challenge a patent successfully would receive 180 days of exclusivity.[182] Such exclusivity would keep drug prices high and thus harm consumers, but the hope was that consumers would benefit ex ante from increased challenges to invalid patents. This logic parallels the more general argument for patent protection itself, that patents cause static loss in the short term but provide dynamic benefits.[183] Hatch-Waxman would tolerate the harm produced by 180 days of exclusivity to provide incentives to challenge the apparently greater harm of unwarranted patent exclusivity.

In passing the Act, however, Congress failed to anticipate that litigating parties would be able to construct settlements that would benefit the generic challenger and the brand-name incumbent at the expense of the consumer. The mechanism for doing so is a "[r]everse payment patent settlement[]," in which the brand-name drug manufacturer pays the generic manufacturer cash,[184] instead of the more typical payment of cash by the accused infringer in a patent suit to the patent holder. The cash payments are typically accompanied by the generic manufacturer's agreement to delay its entry into the market.[185] Numerous commentators have argued that such reverse patent settlements have at least the potential to be anticompetitive, harming consumers rather than achieving the statutory goal of striking down invalid patents.[186]

In the absence of cash payments or other benefits transferred from the brand-name manufacturer to the generic manufacturer, the negotiation would center around the date at which market entry would occur.[187] The generic-drug manufacturer would like to enter the market as soon as possible, and the patent holder would like to delay entry as long as possible. The weaker the patent, the less delay the patent holder would win. The stakes, however, are highly asymmetric. The patent holder faces losing the benefit of exclusivity over potentially the entire remaining life of the patent, while the generic manufacturer's possible gains are limited to 180 days. Both parties can thus benefit by a cash payment to the generic manufacturer in lieu of ex-

182 21 U.S.C. § 355(j)(5)(B)(iv) (2012).

183 *See, e.g.*, Michael Abramowicz, *The Uneasy Case for Patent Races over Auctions*, 60 STAN. L. REV. 803, 809–10 (2007).

184 *See, e.g.*, Elhauge & Krueger, *supra* note 19, at 284.

185 *See id.*

186 *See, e.g.*, *id.*; Hemphill, *supra* note 9, at 639 n.40; Herbert Hovenkamp et al., *Anticompetitive Settlement of Intellectual Property Disputes*, 87 MINN. L. REV. 1719, 1720 (2003).

187 *See* Hemphill, *supra* note 9, at 635.

clusivity.[188] For example, if the parties anticipate a judgment that would result in a loss of $10 billion for the brand-name manufacturer and a gain of $100 million for the generic-drug manufacturer, then a cash payment of $1 billion to the generic manufacturer would make both parties *much* better off.

The only constraint on such settlements has been the prospect of antitrust liability. A naked cash payment with no other concession from the brand-name manufacturer might be too obviously anticompetitive. So, the cash payment is generally bundled with permission for the generic-drug manufacturer to enter at some point. This point, however, may be considerably later than the parties would have agreed to had there been no possibility of a cash payment. To further reduce the antitrust risk, Scott Hemphill has shown, litigating parties have sought to disguise the benefit flowing from the brand-name to the generic manufacturer.[189] For example, the generic manufacturer might license some other intellectual property to the brand-name manufacturer at an inflated price. "The additional term provides an opportunity," Hemphill explains, "to overstate the value contributed by the generic firm and claim that the cash is consideration for the contributed value, rather than for delayed entry."[190]

In *FTC v. Actavis, Inc.*,[191] the Supreme Court found that such settlements may be anticompetitive. The facts of *Actavis* represent a typical reverse payments settlement. The generic firms promised to delay entry, and the patent holder agreed to pay them an amount expected to be over $200 million.[192] The Court found that such a settlement can be anticompetitive if the patentee's motive is to avoid competition.[193] Some reverse payments, however, are permissible, because the payment is not really in exchange for a delay.[194] The reverse payment, for example, might be for "other services."[195] This highlights a central challenge in interpreting reverse payments settlements: because a settlement agreement can encompass a number of different issues, it is

188 *See id.* at 634–35.

189 *Id.* at 633.

190 *Id.* at 663.

191 133 S. Ct. 2223, 2227, 2237 (2013) (applying rule-of-reason analysis to such settlements).

192 The exact amount was tied to the future profits accruing from the patented product, providing the generic firms some incentive to ensure that the patent holder succeeds in the marketplace. *Id.* at 2229.

193 *Id.* at 2236.

194 *Id.* at 2237.

195 *Id.*

difficult for a court to determine what is given in exchange for a reverse payment.

Further complicating the courts' challenge in reverse payments cases is uncertainty about the patent's strength. One might imagine courts unpacking a reverse payments settlement in part by assessing the validity of the patent. The *Actavis* Court indicated that ordinarily this should not be necessary.[196] Aaron Edlin and several coauthors defend *Actavis* on the ground that the relevant question is not whether a patent in fact would be upheld, but the ex ante probability that it would be upheld.[197] They suggest that "[a] large and unexplained payment is a strong signal that the patent holder had substantial doubts that it would win the underlying patent litigation."[198] Still, Edlin et al. acknowledge that there may be situations in which the intent behind a payment is difficult to assess.[199]

Joshua Fischman, meanwhile, highlights a complication in assessing reverse payments: The courts wish to use such settlements as reflecting a prediction in patent litigation, but such settlements will also be anticipating how the courts in antitrust cases will evaluate the settlements.[200] The Supreme Court, Fischman notes, seems to assume that parties "are evidently sophisticated enough to generate a reliable prediction about the outcome of the patent litigation, yet they are completely naïve about the potential for antitrust liability."[201] When the courts assess settlements made in the shadow of law, there are feedback effects that complicate the analysis.[202] Fischman outlines how the courts might apply game theory to generate valid inferences based on the terms of settlements, but he acknowledges that this would face serious challenges.[203] What neither Edlin et al. nor Fischman highlight is that all of this complexity arises because disparate issues are settled together.

The applicability of a bifurcation regime to Hatch-Waxman litigation would be straightforward. Any portion of a settlement defining

196 *Id.* at 2236.

197 Aaron Edlin et al., *The* Actavis *Inference: Theory and Practice*, 67 RUTGERS U. L. REV. 585, 617–19 (2015).

198 *Id.* at 618.

199 *See id.* at 599–60 (discussing situations in which a settlement may also cover unrelated patent litigation).

200 *See* Joshua B. Fischman, *The Circular Logic of* Actavis, 66 AM. U. L. REV. 91, 133 (2016).

201 *Id.* at 132.

202 *See id.* at 131–32.

203 *Id.* at 134–36.

the degree of delayed entry would be bifurcated from any other terms. This would make it impossible for the parties to trade entry delay for cash and would make it impossible for trade-offs to be disguised by side deals. A generic drug manufacturer would be hesitant to agree to a short delay period in the hope of receiving cash because the brand-name manufacturer could renege on the cash component of a deal, and the brand-name manufacturer would not want to pay cash if the generic-drug manufacturer could still insist on immediate entry into the market.

Of course, it is not hard to figure out that making side deals in a Hatch-Waxman settlement agreement voidable would produce a solution to the reverse payments problem,[204] though a number of other more complex approaches have been suggested.[205] But the example highlights that the possibility of bifurcating settlements ordinarily receives no consideration because it is not the general approach to settlement negotiations. Legislators ought to consider the possibility of bifurcating settlements in any context in which a primary purpose of litigation is to protect the rights of third parties. The law should focus on ensuring that the party whose interests are to be aligned with those of the public negotiates at arm's length on the remedy that affects the public. Even if there are other issues that must be addressed or that legitimately may be addressed in a settlement agreement, those issues can be addressed separately, and a rule preventing multiple remedies from being combined into a single agreement may be helpful.

Such a rule could be applicable in intellectual property litigation not involving reverse settlements. Daniel Crane has pointed out that the trade-offs the settling parties make in reverse payments cases are in fact present, though less obviously, in many other cases.[206] All pre-expiration patent settlements involve damages as well as the question of whether the defendant will exit the market,[207] and so even when the defendant pays money to the plaintiff rather than the other way around, the settlement might be different from probabilistic expectations at trial. The parties have an incentive to make the monetary pay-

204 Hemphill recognizes that barring contemporaneous agreements on delayed entry and side deals would address the reverse payments problem: "[T]he FTC could set a rule stating that *any* conferral of value by a brand-name firm, if made contemporaneously with a generic firm's agreement to delay entry, will be considered to exchange payment for delay." Hemphill, *supra* note 9, at 686.

205 *See* Hovenkamp et al., *supra* note 186, at 1756–57 (summarizing proposals).

206 *See* Daniel A. Crane, *Ease over Accuracy in Assessing Patent Settlements*, 88 MINN. L. REV. 698 (2004).

207 *Id.* at 700.

ment less, in exchange for a faster exit from the market,[208] so that they can mutually benefit from higher prices. For example, parties could settle a claim in favor of one party and a counterclaim in favor of the other in order to split markets. Crane points out that "[s]imilar issues could arise in litigation over covenants not to compete, territorially limited franchises, trademarks, tortious interference with contracts, or various kinds of unfair competition or misrepresentation claims."[209] A central goal of each of these areas of law is to protect consumers, even though the cases are litigated by rights holders and their competitors.

A severable settlements regime could serve as a simple but effective tool for preventing settling parties from making trade-offs in favor of market exclusion in any or all of these areas. But would it pass cost-benefit analysis? The benefit is difficult to quantify because it would vary from one context to another. The principal cost is that cases might be more difficult to settle, even if bifurcating settlements in a context not involving third parties would not increase trial rates.[210] When settling parties can make trade-offs at the expense of consumers, then consumers are effectively subsidizing settlement. Parties who go to trial not only face the expense of doing so but also lose their opportunity to make a trade-off at the consumers' expense. Once a case is tried and a final judgment is entered, a payment by one party to the other to exit a market in which it is legally entitled to be would arouse considerable antitrust scrutiny. The same payment made in settlement will generally not receive scrutiny. Bifurcating settlements would eliminate this asymmetry, though the asymmetry could be justified by the social goal of promoting settlement.

The same logic applies in the case of reverse payment settlements, though the argument for bifurcating settlements may be greater there if the consumer costs are especially high. But a parallel to the cost-benefit analysis above can be seen in one argument for efficiency of reverse payment settlements: allowing a patent holder to resolve litigation relatively inexpensively increases the returns on holding a patent and thus the incentive to innovate.[211] Thomas Cotter

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208 *Id.* at 700–01.

209 *Id.* at 702.

210 *See supra* Part I (assessing the effect of bifurcation on trial rates).

211 *See, e.g.*, Thomas F. Cotter, *Refining the "Presumptive Illegality" Approach to Settlements of Patent Disputes Involving Reverse Payments: A Commentary on Hovenkamp, Janis & Lemley*, 87 MINN. L. REV. 1789, 1809 (2003) ("Restricting the parties from settling on terms that involve reverse payments would decrease the value of at least some valid and infringed pharmaceutical patents . . . ."). A complementary argument is that allowing a generic-drug manufacturer to avoid high litigation costs can increase the incentives to file an Abbreviated New Drug Appli-

points out that patentees might pay to settle patent litigation that has little chance of succeeding,[212] thus reducing the litigation costs associated with patent ownership. Herbert Hovenkamp, Mark Janis, and Mark Lemley suggest that only payments in excess of the expected cost of litigation should be presumptively illegal.[213]

The severable-settlements analysis highlights the defense of reverse payment settlements: it may be worthwhile to sacrifice consumer welfare in the short term to encourage settlement of litigation. There are many contexts in which society would not allow this, however. Apple and Samsung could not settle their smartphone lawsuits in part by agreeing to raise prices. If reverse payment settlements are justifiable, the justification must be that the damage to consumers is relatively small, that litigation costs are particularly pernicious when they serve as a tax on innovation, that those costs are especially high for the type of suits at issue, or that the reverse payments are especially likely to be helpful in promoting settlement. Indeed, those who defend reverse patent settlements are generally careful to point out that the efficiency issue is highly case specific: Henry Butler and Jeffrey Jarosch argue that the courts should apply a rule-of-reason antitrust analysis rather than a per se ban or some other presumption.[214] Such an analysis would focus on factors such as the generic manufacturer's entrance date specified in the settlement[215] and the relative size of the reverse payment.[216]

But even if reverse payments should be analyzed on a case-by-case basis, bifurcation might be beneficial. It will still be difficult for courts to unpack any particular settlement to determine how strong the parties believed the patent to be and whether the reverse payment was necessary to help settle the case. Negotiations could be structured to make it easier for the court to perform this analysis. For example, the parties might negotiate along three dimensions: (1) a patentee

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cation and thus challenge the patent in the first place. *See, e.g.*, Asahi Glass Co. v. Pentech Pharm., Inc., 289 F. Supp. 2d 986, 994 (N.D. Ill. 2003) ("A ban on reverse-payment settlements would reduce the incentive to challenge patents by reducing the challenger's settlement options . . . .").

212 Cotter, *supra* note 211, at 1807.

213 Hovenkamp et al., *supra* note 186, at 1759–61; *see also* Elhauge & Krueger, *supra* note 19, at 304.

214 *See* Henry N. Butler & Jeffrey Paul Jarosch, *Policy Reversal on Reverse Payments: Why Courts Should Not Follow the New DOJ Position on Reverse-Payment Settlements of Pharmaceutical Patent Litigation*, 96 Iowa L. Rev. 57, 62 (2010). This position prevailed at the Supreme Court. *See* FTC v. Actavis, Inc., 133 S. Ct. 2223, 2237 (2013).

215 Butler & Jarosch, *supra* note 214, at 116–17.

216 *Id.* at 117–18.

case-strength dimension; (2) a table translating this strength dimension into the amount of time that the generic challenger would need to wait to enter the market if reverse payments were prohibited; and (3) a table translating this time delay into (a) reverse payments from the patentee to the generic manufacturer and (b) increases in the amount of time that the generic challenger must wait to enter. The strength dimension would be negotiated after dimensions two and three, and resolution of that dimension would conclude the settlement.

This differs from other severable-settlement approaches in that two of the dimensions are functions of the third, rather than standalone components of the settlement. This approach makes settlement more complicated but greatly facilitates a court's job in assessing a settlement by isolating the legally questionable but potentially justifiable trade-off between payments and entry time. The parties will have appropriate negotiation incentives with respect to the first and second dimensions, so the court need not focus on them. The parties might have an incentive to provide large reverse payments along dimension (3)(a) in exchange for substantial delays in entry under (3)(b), but this approach will make the trade-off apparent so that the court can consider it. At the same time, the court would be able to consider whether the total amount of reverse payments was justified in light of the expected litigation costs as of particular dates.

This approach is sufficiently alien to the United States' litigation system that we do not anticipate Congress mandating this approach anytime soon. Nor do we take a position on whether the benefits would outweigh the costs. But the exercise illustrates that settlements can be disaggregated into components—some of them conditionals with other components as their antecedents—that are analytically distinct.

C. Protecting Class Members: Attorneys' Fees vs. Damages

There is one area in which the danger of the negotiating parties' reaching a settlement to the detriment of third parties is so significant that the possibility of bifurcating settlements has received considerable attention: class action litigation.[217] The courts' analysis of the bene-

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217 *See, e.g.*, William D. Henderson, *Clear Sailing Agreements: A Special Form of Collusion in Class Action Settlements*, 77 TUL. L. REV. 813, 814–17 (2003) (arguing that courts should adopt a per se rule rejecting clear sailing agreements in class action litigation, encouraging plaintiffs' attorneys to focus solely on the benefit to the class and then petitioning the court for attorneys' fees under the common fund doctrine after the settlement process).

fits and costs, however, has been incomplete, and commentators have not considered alternative approaches to structuring severable settlements. A consideration of the caselaw is useful both as an indication of what the likely objections to bifurcation are and as a means of demonstrating how an appreciation of the theoretical case for bifurcation can address concerns. The analysis also extends easily to other contexts, such as shareholder derivative actions.[218]

Under federal law, a class action settlement must be approved by the court.[219] One reason for this requirement is that the courts wish to ensure that settlements truly represent the interests of the class members.[220] The concern is that the class lawyers might treat themselves as the real parties in interest, and they may sacrifice class members' interests to their own advantage.[221] In settling a class action, class lawyers may be especially concerned about their own fees, and they may be willing to accept a lower award for the class members in exchange for higher fees.[222] The defendant's sole concern is the total amount that it must pay,[223] and so it will generally be willing to trade higher fees for an even greater reduction in damages payments to the class. The result is that, absent bifurcation of settlements, class action settlements will tend at least somewhat to have lower damages and greater fees than would exist if the class lawyers were negotiating solely with the interests of the class in mind. The requirement of judicial approval limits the ability of the negotiators to take advantage of the class, but courts still sometimes approve settlements that include high attorneys'-fee awards and no or minimal value for class members.[224]

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218 In Delaware, judicial approval of derivative suit settlements is required for much the same reason that judicial approval of class actions is required. "This rule is designed to prevent 'private settlements of representative litigation,' whereby the defendant 'buys off' the derivative plaintiff." Edward Tsai, *Success by Another Name: Recognizing a Limited Exception Under Delaware Law to the Indemnification of Derivative Action Settlements*, 64 N.Y.U. ANN. SURV. AM. L. 879, 912 (2009) (footnote omitted). Some commentators, however, believe that "Delaware courts are likely to approve settlements and corresponding awards of attorneys' fees in exchange for release of even meritless claims." *Id.* at 915.

219 FED. R. CIV. P. 23(e).

220 *See In re* Gen. Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig., 55 F.3d 768, 785 (3d Cir. 1995).

221 *Id.* at 788.

222 *See, e.g.*, Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1056 (1996) ("We agree with those who argue that lawyer abuse in class actions is rampant and that the current system, far from keeping this abuse in check, is set up to shield lawyers from the consequences of their misdeeds.").

223 Henderson, *supra* note 217, at 820 ("[A] defendant who has settled a class action lawsuit is ultimately indifferent to how a single lump-sum payment is apportioned between the plaintiff's attorney and the class.").

224 For a recent example, see *Lane v. Facebook, Inc.*, 696 F.3d 811, 817 (9th Cir. 2012),

In response to this concern, at least one court has held that attorneys'-fee negotiations must be bifurcated from negotiation of other issues. In *Prandini v. National Tea Co.*,[225] the court rejected a settlement in which bifurcation had not occurred.[226] "Only after court approval of the damage settlement," the court held, "should discussion and negotiation of appropriate compensation for the attorneys begin."[227] Other courts, however, have not followed *Prandini*.[228] A California state court, for example, encouraged but refused to mandate a bifurcated settlement procedure.[229] Similarly, the Ninth Circuit requires enhanced scrutiny in cases in which attorneys' fees and damages are negotiated simultaneously,[230] and the Texas Supreme Court has emphasized the importance of providing notice to class members about how fees are to be calculated, coupled with a judicial assessment of the reasonableness of fees.[231] Even in courts nominally following *Prandini*, parties sometimes evade the rule by agreeing to a "clear sailing agreement," under which the defendant promises not to contest whatever fees the plaintiff lawyers seek up to some level.[232]

The U.S. Supreme Court has not explicitly assessed the merits of bifurcating settlements for class actions, but it has twice indicated skepticism about requiring severance in a related context: fee determinations under the Civil Rights Attorney's Fees Awards Act.[233] In a 1982 case, the Court recognized the possibility that negotiators might make trade-offs to the detriment of the plaintiff,[234] but refused to require rejection of fee awards made as part of a broader settlement. In a footnote, the Court worried that such a requirement would prevent

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approving a class action settlement in which damages were awarded to a new charity organization whose mission related to the plaintiffs' complaints on a cy pres theory. Judge Kleinfeld dissented, stating, "This settlement perverts the class action into a device for depriving victims of remedies for wrongs, while enriching both the wrongdoers and the lawyers purporting to represent the class." *Id.* at 826 (Kleinfeld, J., dissenting); *see also* Adam Liptak, *When Lawyers Cut Their Class-Action Clients Out of the Deal*, N.Y. TIMES, Aug. 13, 2013, at A12.

225 557 F.2d 1015 (3d Cir. 1977).

226 *Id.* at 1017.

227 *Id.* at 1021.

228 For a review of different courts' approaches, see David Brainerd Parrish, Comment, *The Dilemma: Simultaneous Negotiation of Attorneys' Fees and Settlement in Class Actions*, 36 HOUS. L. REV. 531 (1999).

229 *See* Ramirez v. Sturdevant, 26 Cal. Rptr. 2d 554, 564 (Ct. App. 1994).

230 *See, e.g.*, Mendoza v. United States, 623 F.2d 1338, 1353 (9th Cir. 1980).

231 Gen. Motors Corp. v. Bloyed, 916 S.W.2d 949, 957–59 (Tex. 1996).

232 Henderson, *supra* note 217, at 820–21 (discussing such agreements).

233 42 U.S.C. § 1988(b) (2012).

234 White v. N.H. Dep't of Emp't Sec., 455 U.S. 445, 453 n.15 (1982) (summarizing the argument that there exists "an inherent conflict of interest between the attorney and client").

a defendant from being sure of "his total liability from both damages and fees."[235] The Court similarly worried about uncertainty four years later, concluding, "It is therefore not implausible to anticipate that parties to a significant number of civil rights cases will refuse to settle if liability for attorney's fees remains open, thereby forcing more cases to trial, unnecessarily burdening the judicial system, and disserving civil rights litigants."[236]

Earlier, we showed analytically that bifurcating settlements can increase the likelihood of trial, though for different reasons and only in some circumstances.[237] The Court's concern that defendants will settle cases only if they can settle the whole case at once is misplaced or at least exaggerated. The Court imagines defendants who would be so concerned about achieving certainty that they would refuse to settle what would ordinarily be the major issues—liability and damages—because there would remain some residual possibility that the parties subsequently might be unable to resolve a more minor issue. It might well make sense for defendants to refuse to settle on the merits unless they can also resolve attorneys' fees in a regime, like the present one, in which they are permitted to resolve all issues together. But it would be odd for a defendant concerned about litigation risk to refuse to take the one step that would greatly reduce such risk and open the possibility of eliminating it on the ground that this possibility was not a certainty.[238]

There is a reason that settlements on the merits will be less likely when the issue of attorneys' fees is deferred: The negotiators' ability to make trade-offs to the detriment of the virtually represented plaintiffs increases the gains to trade that settlement creates. The class lawyer and defendant know that if they can reach a settlement, they can in effect take money from a third party. Yet the Court's general concern about conflicts suggests that the Court would not endorse conflicts on the ground that they facilitate settlement. Placing this argument aside, settlements on the merits seem *more* likely because there are fewer issues that must be resolved. To be sure, there may be fewer settlements on the attorneys'-fee question itself, but this is a lesser concern than would be a reduction in settlements on the merits.

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235 *Id.* at 454 n.15. The Court concluded, "Although such situations may raise difficult ethical issues for a plaintiff's attorney, we are reluctant to hold that no resolution is ever available to ethical counsel." *Id.* The phrase "reluctant to hold" suggests that the Court's view was tentative.

236 Evans v. Jeff D., 475 U.S. 717, 736–37 (1986) (footnote omitted).

237 *See supra* Part I.

238 Defendants have sometimes insisted on global settlements in contexts in which they faced bankruptcy. *See, e.g.*, Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 597 (1997).

Adjudicating attorneys' fees need not require a full exploration of all issues that would be considered at trial on the merits, and also will likely be cheaper because the total stakes are lower. Thus, concerns about bifurcation should be less in this context than in some others, such as the compensatory-punitive damages context,[239] where the issues that must be tried if either part of a settlement fails are mostly the same.

We suspect that most courts' reluctance to insist on bifurcating settlements in this context, despite the clear acknowledgment that class lawyers may be sacrificing plaintiffs' interests for their own,[240] may reflect a discomfort with restriction of the settlement process. This may in part be attributable to the general view that settlement is beneficial because it saves resources, but also may simply be a reflection of what has long been understood as the legal order: parties are usually free to enter into whatever settlements they like, and where judicial supervision is necessary to protect nonparties, judges should simply examine whether settlements are fair, rather than insist on a particular procedure designed to ensure fairness. Indeed, there is a legitimate question whether courts, which traditionally have simply examined settlements for fairness, should decree that settlements that were not bifurcated are invalid. Perhaps a bifurcation regime should be created only by the legislature.

Yet it is also possible for parties voluntarily to agree to a bifurcated settlement. Certainly, where parties have bifurcated settlement, that should be given great weight in a court's assessment of whether a settlement is fair. If a plaintiff and a defendant have independently agreed to damages and attorneys' fees instead of combining them into a single settlement, that procedural protection should, absent special circumstances such as repeat-player interaction among the attorneys, provide enough evidence of the settlement's fairness. If courts began to give credit for voluntary bifurcation, they might also begin to feel more comfortable deducting credit in cases in which there is no bifurcation. Indeed, courts already apply enhanced scrutiny in such cases,[241] and so perhaps all that is needed is for the courts to place even greater weight on this structural consideration than they already do. Our hope is that our analysis of bifurcation in general can help normalize bifurcation so that it will seem less strange to judges. Judges

239 *See supra* Section III.A.

240 *See* Koniak & Cohen, *supra* note 222, at 1056.

241 *See* Parrish, *supra* note 228, at 542–48.

might then feel more comfortable giving greater scrutiny to settlements reached without bifurcation.

At the same time, a recognition in general of the possibility of bifurcating settlement can lead to more creativity in applying it to address concerns. If, for example, the Court were correct that the bifurcated-settlements regime it was considering would frustrate defendants eager for complete resolution, severable settlements might be preferable. With severable settlements, parties would negotiate both issues at once. There would be some danger that the other side would renege, perhaps pretending to be satisfied with one part of a settlement because it was very happy with the other, but this seems unlikely given a tentative agreement following a negotiation in which each side has an incentive to make the best argument it can as to each issue. Neither side would have an incentive to propose a trade-off across issues because both parties would recognize that such a settlement would not be stable. So, the parties would work to ensure that they had arrived at both damages and attorneys'-fees settlements that were independently mutually agreeable. Conditional on arriving at an agreement, severable settlements will be more likely to produce a complete agreement than the first half of a seriatim bifurcated settlement where the second half has not yet been negotiated.

Another possible structure would be seriatim bifurcated settlements with the order of issues reversed. It might be undesirable to produce a final determination of attorneys' fees before damages because it is difficult to assess the value that attorneys have provided before the case is finished and because once their fees are established, attorneys might have an incentive to shirk their responsibilities. It should, however, be possible to produce a schedule of fees dependent on factors such as the total recovery of the plaintiff class, the total number of hours worked, and the stage of litigation reached. A court would need to consider this somewhat critically because of the danger that the plaintiffs' attorneys and defendants would agree to a relatively flat fee schedule that would give plaintiffs little incentive to seek out high damages. But, at least if the fees are to be paid in addition to damages rather than out of damages, the court would need to focus only on the difference in fees for different levels of work and success, rather than the absolute level, because it could be confident that the plaintiffs' attorneys would want damages as high as possible and the defendant would want damages as low as possible. Even if the fees are to be deducted from damages, the judicial inquiry may be far easier than a fairness assessment of an ex post fee award. In that situation,

the court may have little ability to determine whether the attorneys had sufficient incentive to fight hard for their clients because it may have difficulty establishing whether the attorneys thought that they would make more with greater success.[242]

Our purpose is not to argue that severable settlements would be superior to bifurcated settlements in this context or that resolving attorneys' fees first is necessarily desirable in a regime of bifurcated settlement. Nor do we contend that bifurcating is the best or sole solution. William Henderson, for example, argues that a guardian ad litem be appointed to represent the class in the negotiation of attorneys' fees after the settlement on the merits.[243] The guardian ad litem would then receive a small percentage of the settlement as well.[244] This is another strategy for addressing settlement trade-offs that are adverse to third parties, and one could also imagine using it in other contexts, for example by requiring a government lawyer to approve allocation of damages as compensatory and punitive, or giving representatives of consumer groups an explicit seat at the bargaining table in antitrust negotiations. Meanwhile, there are other strategies that could be used as alternatives or complements to bifurcation in the attorneys' fees context, such as deeper judicial review or stronger enforcement of ethical rules.[245] Our claim is simply that bifurcated settlements should be on the regulatory menu. It should not be viewed reflexively as a mechanism that threatens litigant autonomy and the prospect of settlement.

Conclusion

Bifurcating settlements reduces the chance that litigants will make trade-offs across different components of a settlement. This may be beneficial when these trade-offs come at the expense of third parties' interests—for example, the interests of children in being placed with a parent best able to provide care and still able to provide financial support, the government in taxing punitive damages, consumers in low prices, or class members in the allocation of settlement proceeds between them and their attorneys. By treating these seemingly dispa-

242 Henderson, *supra* note 217, at 820–21.

243 Henderson argues that "the specter of a court-appointed advocate challenging the attorneys' fee petition will most likely have a significant impact on bargaining dynamics and trade-offs proposed by the defendant and class counsel." *Id.* at 837.

244 *Id.* at 831.

245 *See, e.g.*, Arthur B. LaFrance, *Public Interest Litigation, Attorneys' Fees, and Attorneys' Ethics*, 16 Envtl. L. 335, 338–39 (1986) (discussing the ethical dilemmas that defense counsel face when settlement negotiations are not bifurcated).

rate contexts together, we have aimed to provide a unified theoretical framework for assessing bifurcation. This framework helps establish not only when bifurcation may be useful, but also the trade-offs that exist in different approaches to structuring bifurcation. Our broader aim is to counter the sense that many lawyers have that there is something inherently wrong with bifurcation. While bifurcation has not yet found a foothold in the legal system, there are sound reasons for insisting on it when trade-offs at the expense of third parties are a danger, and there is little reason to believe that bifurcation will have a significant adverse impact on the prospects for settlement. Still, as our analysis of child custody demonstrates, the benefits and costs of bifurcation are highly context specific, and further experiments and study in particular areas may help determine whether bifurcation is warranted and, if so, how it might be structured.