Indiana Law Journal

Volume 73 | Issue 1 Article 2

Winter 1997

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INTRODUCTION

Corporations, politicians, and the media generally share the sense that litigation in the United States is inordinately expensive and that our system of litigation thus deters productive conduct.[1] While this belief is widely held, it is nevertheless quite controversial.[2] Any thorough analysis of this problem must pick up where popular opinion leaves off. In order to test popular sentiment, it is necessary to examine, first, how certain procedural rules affect deterrence, and second, whether our particular procedural framework does, in fact, lead to overdeterrence when compared to other procedural systems.

It is self-evident that parties make litigation and settlement decisions based upon the procedural setting, and not just the merits, of a given case. In particular, lawyers and clients alike understand that the cost of litigation may affect outcomes. It is less obvious, however, which procedural rules contribute to the costliness of litigation and whether these rules together lead more often to plaintiffs foregoing meritorious suits, to defendants paying for meritless ones, or to parties settling meritorious suits early and thereby avoiding the costs of litigation entirely. Without further inquiry, it is impossible to determine whether expensive litigation leads defendants to expect to pay more, less, or the same amounts for suits as they would under substantive law alone. Such expectations are at the core of any analysis of how procedural rules affect deterrence.

To date, legal scholarship has not focused on the interplay between substantive law deterrence and civil procedure.[3] In the area of tort law, for example, legal scholars have examined the ability of negligence and strict liability regimes to achieve efficient and fair deterrence and compensation, without taking into

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1. *See generally* Joseph R. Biden, Jr., *Congress and the Courts: Our Mutual Obligation*, 46 STAN. L. REV. 1285, 1286 (1994) ("[E]conomic concerns rather than the merits of a case too often govern the decision to file a civil suit."); Terence Dunworth & James S. Kakalik, *Preliminary Observations on Implementation of the Pilot Program of the Civil Justice Reform Act of 1990*, 46 STAN. L. REV. 1303, 1303 (1994) ("[A]ccording to the oft-heard indictment of the civil justice system, . . . American businesses face difficulty competing with foreign adversaries."); Marc Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 6-11 (1983) (describing public perceptions of litigiousness); Linda S. Mullenix, *Discovery in Disarray: The Pervasive Myth of Pervasive Discovery Abuse and the Consequences for Unfounded Rulemaking*, 46 STAN. L. REV. 1393, 1395-96 (1994) (blaming media for public perceptions that we are exceedingly litigious, that plaintiffs file frivolous lawsuits, and that greedy lawyers typically engage in discovery abuse); Dan Quayle, *Civil Justice Reform*, 41 AM. U. L. REV. 559 (1992).

2. *See, e.g.*, Galanter, *supra* note 1, at 11 (questioning the productivity of our present adversary system); Mullenix, *supra* note 1, at 1395-96 (describing myth of widespread discovery abuse).

3. One exception worth noting is J. Robert S. Pritchard, *A Systemic Approach to Comparative Law: The Effect of Cost, Fee and Financing Rules on the Development of Substantive Law*, 17 J. LEGAL STUD. 451 (1988) (arguing that different litigation rules may alter the evolution of substantive rules across legal systems).

account the effect of civil procedure.[4] Conversely, civil procedure scholarship has explored how isolated rules influence settlement dynamics without regard to the aggregate effect of these rules on ex ante behavior (sometimes termed "primary conduct").[5] Accordingly, neither area of scholarship has examined how a particular procedural regime may lead defendants to expect to pay for nonnegligent conduct *despite* a governing negligence standard, to pay for accidents they do not cause, or conversely, to escape liability for meritorious claims.

This Article explores that gap between tort law scholarship and civil procedure. Part I provides a brief summary of the relevant scholarship on tort law deterrence. As noted above, that scholarship explores how tort law could achieve its goals—efficient and fair deterrence and compensation—based on substantive law alone.

Part II then explores why potential defendants cannot assume that substantive law will determine their tort payments. Drawing upon civil procedure scholarship and settlement theory, Part II describes how America's liberal discovery rules, together with its refusal to shift attorneys' fees, often lead nonmerits factors to overshadow the merits when plaintiffs decide to file, and parties decide to settle,

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4. Some scholars have questioned whether tort law actually achieves the deterrence that tort theory envisions. *See* John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965, 966-67 (1984) (explaining how uncertainty over a legal rule's likely application may result in undercompliance or overcompliance); Gary T. Schwartz, *Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?*, 42 UCLA L. REV. 377, 381-87 (1994) (summarizing claims that tort law is either superfluous or futile). Others have addressed procedural issues tangentially, for example, by comparing the administrative costs of a strict liability regime with those of a fault-based one. *See infra* notes 23-24 and accompanying text. But none has looked to procedural rules to explain tort law's actual deterrent effect.

5. Scholars have considered the combined effect of several procedural rules on the quantity and expense of cases filed, without distinguishing meritorious cases from meritless ones or examining their effect on deterrence. *See, e.g.*, Arthur R. Miller, *The Adversary System: Dinosaur or Phoenix*, 69 MINN. L. REV. 1, 8-11 (1984); Thomas D. Rowe, Jr., *American Law Institute Study on Paths to a "Better Way": Litigation, Alternatives, and Accommodation*, 1989 DUKE L.J. 824, 851-55. Law and economics scholars have made great progress in understanding the dynamics of litigation and settlement. They have explored settlement theory in depth, and have addressed the ways in which different procedural rules may alter settlement dynamics. *See* Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LITERATURE 1067 (1989) (reviewing the literature). But, this improved understanding of litigation generally has taken the form of isolated studies of isolated procedural issues. The effect of a particular rule on settlement dynamics is sufficiently complicated that scholars are understandably hesitant to consider the combined effect of several procedural rules at once, let alone the effect of an entire procedural system, on the substantive law. *See id.* at 1085. This Article's analysis of litigation rules accordingly does not rely exclusively upon law and economics theory—which often rests upon restrictive assumptions that hinder extrapolation—but rather refers, in addition, to empirical studies and other traditional legal scholarship. *See, e.g.*, Galanter, *supra* note 1; Mullenix, *supra* note 1; David M. Trubek et al., *The Costs of Ordinary Litigation*, 31 UCLA L. REV. 72 (1983). This Article further attempts to avoid the pitfalls of such a broad inquiry by narrowing the goal: it seeks to determine only the effect of litigation rules on a defendant's pocketbook (which is crucial to deterrence) and avoids further conclusions about the effects on court congestion or attorneys' profits.

lawsuits. Liberal discovery and non-fee-shifting—two core features that distinguish the American system from the English model—result in unreasonably high litigation costs that are beyond a party's control, and that parties must bear regardless of the merits.

Assuming that the underlying substantive law is structured appropriately, these characteristics of litigation in the United States could result in underdeterrence, efficient deterrence, or overdeterrence depending upon whether they (1) lead plaintiffs to forego meritorious lawsuits or to settle such suits for less than the merits warrant, (2) lead both parties to settle early based on the merits and avoid entirely the costs of litigation, or (3) lead defendants to pay too much for meritorious lawsuits and significant amounts for even meritless ones. Because the literature to date has considered discovery and non-fee-shifting rules in isolation, it has not determined the ultimate effect on deterrence.

Part III resolves this uncertainty by considering the effects of discovery and non-fee-shifting rules together with another American departure from the English model: the availability of contingent-fee arrangements. When the three sets of rules are considered together, it becomes clear that defendants' total tort payments exceed what they would pay under substantive law alone.

Part III.A explains how contingent-fee arrangements increase the rate at which plaintiffs file meritorious suits—even small ones—principally by shifting some litigation risk to attorneys who can spread it over the many suits in their caseloads. Thus, contingent-fee arrangements largely eliminate the possibility that high litigation costs will enable defendants to avoid liability completely.

Part III.B demonstrates that contingent-fee arrangements also preclude defendants from expecting to settle cases for less than the merits warrant. By shifting risk to attorneys, contingent-fee arrangements improve plaintiffs' bargaining power. In addition, contingent-fee arrangements provide lawyers with an incentive to hold down litigation expenses, and thereby enable plaintiff-attorney teams (the predominant users of contingent-fee arrangements) to manage escalated litigation costs better than defendant-attorney teams. This, in turn, enables plaintiffs to threaten continued litigation, thereby bolstering their leverage in settlement negotiations. These positive effects on settlement amounts may be mitigated somewhat by conflicts of interest between plaintiffs and their attorneys, who have greater incentives to settle than their clients. On balance, however, contingent-fee arrangements ensure that settlements are sufficiently large that defendants cannot expect their tort settlements routinely to fall short of what they would pay under substantive law alone.

Part III.C demonstrates that in addition to payments for injuries in meritorious cases, defendants must pay significant presettlement litigation costs. Defendants cannot hope to settle all cases early for exactly what the merits warrant, thereby escaping the high costs of litigation. If defendants adopt a strategy of settling, they may reduce their legal fees, but they will also increase their payments to plaintiffs, and invite more filings as they develop a reputation for settling.

Finally, Part III.D demonstrates that defendants' total tort payments include not only legal fees for meritorious cases, but also legal fees and settlements in meritless cases. Part III.D explains why plaintiffs and their contingent-fee attorneys may hope to profit from meritless cases, and why defendants must bear some expense to defend and settle these cases. The discussion thus concludes that

when the availability of contingent-fee arrangements is considered together with America's approach to discovery and fee shifting, defendants not only must pay for meritorious claims—as substantive law alone would require—but also must pay significant presettlement litigation expenses and substantial amounts to dispose of meritless cases.

Part IV then returns to tort theory, exploring how the realities of litigation and settlement described in Parts II and III alter the deterrence and compensation postulated by tort theory in Part I. A procedural rule's deterrent effect may depend upon its foreseeability to potential defendants, and Part IV explains that our litigation system's structure affects settlement amounts in a sufficiently predictable manner as to have a major impact on tort law deterrence. Ultimately, the U.S. procedural system alters deterrence incentives in two ways not taken into account by tort theory. First, defendants must structure their conduct in anticipation of meritless, as well as meritorious, cases. The discussion demonstrates that a defendant's fear of liability without regard to causation is more serious than his fear of being held liable without regard to a governing negligence rule, but that both give rise to needless social costs. Second, the prospect of defending even meritorious lawsuits results in overdeterrence because potential defendants must anticipate paying for litigation as well as for tort injuries. Part IV argues that some portion of a defendant's litigation expenses should not be internalized along with the costs of accidents because defendants are not the "cheapest cost avoiders"[6] with respect to these costs. When a defendant's total litigation costs are considered, the tort system overdeters efficient conduct.

Finally, Part V suggests that although the problem of overdeterrence is quite serious, it can be remedied without abandoning America's approach to discovery, fee shifting, and contingent-fee arrangements that are central to preserving access to justice. Rather, the system's ills may be cured through adjustments at the margins. Part V notes possible reforms—building principally upon Federal Rules of Civil Procedure 11 and 68—that could lead defendants to expect to pay amounts more closely tied to the merits.

I. TORT THEORY

Our system of tort law is a harm-based, rather than a risk-based, regime. Although the government may regulate risky behavior directly (e.g., by punishing reckless driving), tort law comes into force only when that risky behavior has resulted in some tangible harm (e.g., when the driver hits a pedestrian).[7] Thus, two people may engage in the same risky conduct and yet only the person whose conduct actually results in an accident can be held liable under our tort law. One could imagine an alternative risk-based regime, under which people would be

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6. GUIDO CALABRESI, THE COST OF ACCIDENTS 254 (1970).

7. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 30, at 165 & n.5 (5th ed. 1984). This Article does not specifically address intangible offenses, such as slander, where no proof of damage is required. *See id.* § 112, at 788 (explaining that proof of the defamation itself is considered to establish the existence of some damages, and that the jury is permitted to estimate their amount without other evidence).

taxed for the risks they create, and the proceeds of this tax used to pay victims whenever those risks came to fruition.[8] Either way, tort law would promote the same dual goals: deterrence of certain risky conduct and compensation of accident victims.

A. A Fault-Based System

As every first-year law student quickly learns, even within our harm-based system there are different ways to pursue these twin goals.[9] A fault-based regime seeks to deter only unreasonably risky behavior by creating liability only for negligent acts. Every day, each of us risks both our own well-being and that of others. Without taking such risks, or imposing them upon others, we could not perform basic tasks, such as driving to the grocery store, that are essential to a productive life. From an economic perspective, it would be inefficient for tort law to deter reasonable risks.[10] Hence, the Hand Formula ensures that only inefficient risks—that is, those that could be avoided without undue cost—will be punished.[11]

In addition to defending this negligence standard as efficient, legal scholars have sought to defend it as fair.[12] Because a rational individual would accept only reasonable risks for himself, a rational individual may only ethically impose reasonable risks upon other persons. To expose another person to risks that we would not rationally accept for ourselves—that is, to expose another to risks that outweigh potential rewards—is to use that other person to our own end. It therefore seems just that the creator of an unreasonable risk should compensate his or her victim, but that the costs of reasonable risks can be left where they fall (i.e., on the accident victim).[13]

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8. *Cf.* W. PAGE KEETON ET AL., TORT AND ACCIDENT LAW 875-82 (1983) (describing broad New Zealand no-fault scheme in which funding for accidents comes from an employment fund, a motor vehicle fund, and a supplementary catch-all fund) (citing TERENCE G. ISON, ACCIDENT COMPENSATION: A COMMENTARY ON THE NEW ZEALAND SCHEME (1980)).

9. As this Article's goal is simply to demonstrate how procedural rules can vary the deterrent and compensatory effects of a substantive law regime, and not to debate which substantive law regime is best, a full-blown discussion of the various theoretical debates in tort scholarship would be extraneous.

10. *See* KEETON ET AL., *supra* note 7, § 31, at 170 ("Nearly all human acts, of course, carry some recognizable but remote possibility of harm to another. No person so much as rides a horse without some chance of a runaway, or drives a car without the risk of a broken steering gear or a heart attack. But these are not unreasonable risks.").

11. *See* United States v. Carroll Towing Co., 159 F.2d 169, 173 (2d Cir. 1947) (weighing the probability ("P") that an accident will occur and the likely loss ("L") if an accident does occur against the burden ("B") of taking "adequate preparations" to prevent the accident).

12. Of course, a utilitarian might defend the negligence standard's morality precisely because it promotes efficiency.

13. *See* Richard A. Posner, *The Concept of Corrective Justice in Recent Theories of Tort Law*, 10 J. LEGAL STUD. 187, 200 (1981) ("[C]orrective justice requires annulling a departure from the preexisting distribution of money or honors in accordance with merit, but only when the departure is the result of *an act of injustice*, causing injury.") (emphasis in original); Glanville Williams, *The Aims of the Law of Tort*, 4 CURRENT LEGAL PROBS. 137, 151 (1951).

B. A Regime of Liability Without Regard to Fault

A regime that imposes liability without regard to fault has the same deterrence goal as the fault-based system described above: to discourage only *unreasonable* risks.[14] Yet, proponents of strict liability recognize that often the defendant may be better able than a court to evaluate the risks imposed and the means by which those risks may be reduced.[15] If an actor knows that he will be liable for the accidents he causes, without regard to negligence, then he will weigh the risk of accidents against the cost of preventive measures and pursue efficient preventive measures.[16] Given that the person who controls an activity (e.g., the manufacturer of a product) is in the best position to minimize accident costs (i.e., is the "cheapest cost avoider"), it makes sense to impose the costs of accidents upon him.[17]

Moreover, by internalizing the accident costs of an activity, strict liability not only encourages an actor to adopt efficient safety precautions while engaging in an activity, but also promotes the efficient allocation of resources *across different activities*.[18] For example, strict liability not only encourages a common carrier (e.g., a railroad, airline, or bus company) to take appropriate safety precautions, but also, by internalizing the accident costs of an unsafe mode of transportation and thus making it more expensive, strict liability encourages passengers to choose a safer mode of transport.[19]

In addition to reducing the "primary" costs of accidents (and accident avoidance measures), strict liability reduces the "secondary" costs of accidents—that is, the costs to society of the accidents that do occur.[20] Strict liability does this, the scholarship contends, by placing accident costs upon someone who is better able than the victim to spread the costs of an accident over the broader group of people who benefit from the activity that has caused the

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14. The economic and moral arguments for strict (or faultless) liability are perhaps even more fully developed than those for fault-based liability. Guido Calabresi is generally credited with the economic analysis of strict liability. *See* CALABRESI, *supra* note 6; Guido Calabresi & Jon T. Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055 (1972). Jules Coleman, Richard Epstein, George Fletcher, and Ernest Weinrib are among those who have discussed strict liability's ethical underpinnings. *See* JULES L. COLEMAN, RISKS AND WRONGS (1992); Richard A. Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151, 168-69 (1973); George P. Fletcher, *Fairness and Utility in Tort Theory*, 85 HARV. L. REV. 537 (1972); Ernest J. Weinrib, *Legal Formalism: On the Immanent Rationality of Law*, 97 YALE L.J. 949 (1988).

15. *See* CALABRESI, *supra* note 6, at 69 ("[N]o one knows what is best for individuals better than they themselves do."); Calabresi & Hirschoff, *supra* note 14, at 1060.

16. *See* CALABRESI, *supra* note 6, at 73.

17. *See* Calabresi & Hirschoff, *supra* note 14, at 1060.

18. *See* CALABRESI, *supra* note 6, at 73.

19. A negligence standard does not encourage such cross-industry comparisons, but rather asks whether a particular defendant in the particular circumstances made a reasonable choice (often measured by reference to industry standards). *Cf. id.* at 68-69 (describing "general" versus "specific" deterrence).

20. *See id.* at 27-28; KEETON ET AL., *supra* note 7, § 98, at 692-93.

accident.[21] As mentioned above, our tort system is a harm-based system, under which those involved in risky behavior, whether they create or bear a risk, will not suffer any of its consequences unless the risk actually results in an injury. However, by internalizing the costs of accidents, and making risky activities more expensive, strict liability effectively spreads the costs of those injuries over all involved.

For example, millions of passengers may travel by airplane without mishap. By requiring airlines to compensate those few passengers who suffer harm from infrequent crashes, strict liability generally increases the cost of air travel, a cost which airlines presumably will pass on to all of their passengers through more expensive tickets. Strict liability thereby spreads the costs of a few passengers' suffering over the multitude of passengers who bear the same risk but escape harm. Strict liability, then, provides a mandatory insurance scheme for air travel, or any other activity to which it applies. Because the relevant activity's many beneficiaries are better suited to bear large accident costs than its few victims, this insurance scheme spreads the costs of accidents more efficiently than would a system that leaves those accident costs that are not the result of negligence upon the few, unlucky victims.[22]

Finally, strict liability reduces "tertiary" costs, that is, the transaction costs associated with endeavors to reduce primary and secondary costs.[23] By removing the issue of fault from litigation, strict liability may reduce such transaction costs as having a jury determine whether the defendant acted negligently.[24]

While strict liability has been defended on several ethical grounds,[25] the most straightforward moral justification of strict liability is that it is fair, as well as efficient, for the beneficiaries of an activity to bear its costs. While negligence liability leaves the costs of reasonable risks where they fall (upon accident victims), there is a strong moral argument against such a practice. This argument is most obvious in the case of nonreciprocal risks.[26] Even if a construction company uses dynamite efficiently, taking safety precautions and ensuring that

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21. *See* CALABRESI, *supra* note 6, at 51.

22. Calabresi summarizes:

> The advantages of interpersonal loss spreading would probably be stated as a pair of propositions: (1) taking a large sum of money from one person is more likely to result in economic dislocation, and therefore in secondary or avoidable losses, than taking a series of small sums from many people; (2) even if the total economic dislocation were the same, many small losses would be preferable to one large one simply because people feel less pain if 10,000 of them lose one dollar apiece than if one person loses $10,000.

Id. at 39 (footnote omitted). For a more in-depth discussion of how loss spreading may reduce secondary accident costs, see *id.* at 39-67.

23. *See id.* at 28.

24. *See id.* at 251 ("The most expensive aspect of the fault system is its case-by-case jury determination of who should bear losses."); KEETON ET AL., *supra* note 7, § 98, at 693 (arguing that proof of the existence of fault or negligence should no longer be required).

25. *See generally* COLEMAN, *supra* note 14; Epstein, *supra* note 14; Fletcher, *supra* note 14; Weinrib, *supra* note 14.

26. *See generally* Fletcher, *supra* note 14 (introducing "reciprocity" paradigm as substitute for traditional "reasonableness" paradigm in tort law).

blasting's rewards outweigh its risks, the company may nevertheless expose others to greater risk than people generally impose upon one another through regular interaction. It would be unfair to fail to compensate the injured passerby, who would never impose such a risk upon the construction company, simply because the construction company's risks are cost justified. If the construction company, or the owner of the building under construction or perhaps society more broadly, benefits from the extremely dangerous activity,[27] it is only fair that these beneficiaries should be required to compensate their victims. Recognizing this, tort law has long imposed strict liability upon ultrahazardous activities.[28]

This moral rationale for liability for nonreciprocal risks can be extended to reciprocal risks as well.[29] For example, in *Lubin v. Iowa City*,[30] Mrs. Lubin was entitled to compensation when a water main burst, flooding her basement. Prior to the accident, Mrs. Lubin and other residents had benefitted equally from lower water prices attributable to the city's reasonable policy of refusing to dig up streets to test water mains. Mrs. Lubin and other residents likewise bore equal risks, for nobody knew exactly where the city's water pipes would give way or whose basement would be flooded. Nevertheless, the water company and, indirectly, its customers, were required to reimburse Mrs. Lubin. It would have been unjust to allow each resident to enjoy the benefits of water service but hope the burdens would be borne by another. Rather, it is fair that all those who benefit should share in the costs.[31]

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27. *Cf.* MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1780-1860, at 97-101 (1977) (describing rise of negligence standard as a subsidy to "those who undertook schemes of economic development").

28. *See* RESTATEMENT (SECOND) OF TORTS § 520 (1977); KEETON ET AL., *supra* note 7, § 78, at 545-59.

29. For a moral defense of liability based upon causation alone, see Epstein, *supra* note 14, at 168-69 & n.49.

30. 131 N.W.2d 765 (Iowa 1964).

31. The Supreme Court of Iowa in *Lubin* summarized risk cost allocation as follows:

> The risks from such a method of operation should be borne by the water supplier who is in a position to spread the cost among the consumers who are in fact the true beneficiaries of this practice and of the resulting savings in inspection and maintenance costs. When the expected and inevitable occurs, they should bear the loss and not the unfortunate individual whose property is damaged without fault of his own.

Id. at 770; *see also Recent Development*, 104 HARV. L. REV. 1723, 1728-30 (1991) (suggesting "benefit-burden fairness" as a justification for tobacco company liability); *cf.* JOHN RAWLS, A THEORY OF JUSTICE 28 (1971) ("Justice denies that the loss of freedom for some is made right by a greater good shared by others."). *But cf.* Jules L. Coleman, *Corrective Justice and Wrongful Gain*, 11 J. LEGAL STUD. 421, 423-25 (1982), *reprinted in* JULES L. COLEMAN, MARKETS, MORALS AND THE LAW 184, 185-87 (1988) (noting disparity between losses to victim and gains to tortfeasor as problematic for moral defenses of strict liability); Nancy A. Weston, *The Metaphysics of Modern Tort Theory*, 28 VAL. U. L. REV. 919, 977-86 (1994) (summarizing Coleman's work).

C. Common Elements of Negligence and Strict Liability Regimes

Despite differences, negligence and strict liability regimes share important features. First, both respond only to those risks that actually result in accidents; as noted above, they are harm-based, not risk-based, regimes.[32] By ensuring a sufficient connection between the defendant's conduct and the plaintiff's injury, tort law provides an economically, and morally, coherent deterrent message: a person can anticipate being held liable for a risky activity only if that activity actually results in a concrete harm to someone else. Conversely, a person who structures his or her activity so that it cannot harm someone else can be sure of avoiding liability.

Second, strict and fault-based liability regimes both endeavor to deter only *unreasonable* risks. A fault-based regime leads defendants to expect to pay only for injuries caused by unreasonable risks. A strict liability regime encourages people to act reasonably by threatening them with liability for *all* injuries they cause, inducing them to figure out for themselves which risks are reasonable.

II. HOW COSTS MAY OVERWHELM MERITS: AMERICA'S APPROACHES TO DISCOVERY AND FEE SHIFTING

The moral and economic theories outlined above rely upon substantive rules of law to lead people to act efficiently and fairly. These theories implicitly assume a world in which the only incentives provided by the legal system are those found in substantive law.[33]

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32. This requirement of a proven connection between the defendant's conduct and the plaintiff's injury—that is, causation—is found in other tort doctrines as well. In the context of an intentional tort, such as battery, a plaintiff should have little difficulty proving that the defendant's act "cause[d] an unpermitted contact." KEETON ET AL., *supra* note 7, § 9, at 41. Under the negligence-related evidentiary doctrine of res ipsa loquitur, the plaintiff must show that the defendant had exclusive control over the instrumentality of the accident, and that this kind of accident does not ordinarily occur in the absence of negligence. *See id.* § 39, at 244. Just as under negligence and strict liability, then, under the tort doctrines of battery and res ipsa loquitur there must always be a proven connection between the defendant's activity and the actual harm suffered by the plaintiff. Under res ipsa loquitur doctrine, this connection may be established by proving that the defendant controlled the instrumentality of the accident, rather than that he *caused* the accident; in either case, the effect is similar.

33. This is not to say that scholarship has completely ignored the effect of factors other than substantive law on deterrence. For example, scholars have long recognized the most obvious way in which procedural reality may affect real-world deterrence: a tortfeasor may hope that he will not be caught. *See, e.g.*, Calfee & Craswell, *supra* note 4, at 979. Scholars have gone beyond this basic uncertainty about detection and prosecution to consider the effect of other sorts of uncertainty upon the incentives created by a rule of substantive law. *See id.* at 974-84, 986-89 (describing the effect on deterrence of uncertainty regarding a court's views on duty of care and damages); Mark F. Grady, *A New Positive Economic Theory of Negligence*, 92 YALE L.J. 799, 805-06 (1983) (discussing the effect on deterrence of uncertainty over the precaution level that courts will require). Also, scholarship has considered the effects of inaccurate-versus-accurate litigation upon deterrence incentives. *See* Louis Kaplow, *The Value*

In reality, however, the procedural rules governing litigation may provide incentives as powerful as those provided by substantive rules. In fact, nonmerits factors often drive litigation and settlement. As explained below, litigation rules may affect the value of a lawsuit by determining the costs of litigation.[34] This Part first discusses the dynamics of litigation and settlement generally, and then focuses on the combined effect of discovery and non-fee-shifting rules on litigation costs. These rules together lead to litigation expenses that are unreasonably high, are beyond a party's control, and are borne regardless of the merits. As a result, legal costs may overshadow the merits when plaintiffs decide to file, and parties decide to settle, lawsuits.

A. The Importance of Legal Fees in Litigation and Settlement

The costs of resolving legal disputes are significant. Plaintiffs' attorneys typically work for a contingent fee[35] equal to about one-third of their clients' recovery.[36] Because defense attorneys usually charge by the hour, their fees depend upon the course of litigation, such as the extent of pretrial motion practice and discovery, and whether the case proceeds to trial.[37] Regardless of whether a case actually goes to trial, however, legal expenses generally account for a significant portion of the total amount a defendant expects to pay, particularly in smaller cases.[38]

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of Accuracy in Adjudication: An Economic Analysis, 23 J. LEGAL STUD. 307 (1994); discussion *infra* Part IV.A. Moreover, Calabresi has recognized that there may be more to the relationship between primary and tertiary accident costs than he had explored, implicitly suggesting that transaction costs may influence deterrence. *See* CALABRESI, *supra* note 6, at 29-30 (noting that differences between the three sets of accident costs may be unclear, and that the three subgoals of cost reduction may conflict, but arguing nevertheless that the division of accident costs is "useful for analytical purposes"). The scholarship has not, however, considered the effect of litigation rules on deterrence incentives in a systematic way.

34. Procedural rules regarding the choice of forum and factfinder also affect the value of lawsuits by altering the likelihood of prevailing at trial. This Article leaves those procedural rules for another day and confines its analysis to rules that influence deterrence through their effect on costs. This Article also leaves unaddressed the many other variables that might alter a lawsuit's value, such as the ancillary effects of a pending lawsuit on a defendant's reputation.

35. *See* Trubek et al., *supra* note 5, at 111 ("[Seventy-one percent] of plaintiffs in our sample were represented by lawyers paid on a contingency basis.").

36. Even where the plaintiff's attorney charges by the hour, the fees typically exceed 20% of the plaintiff's recovery. *See id.* (noting that the recovery-to-fee ratio in the case of contingent-fee attorneys averages 3 to 1, while in the case of hourly-fee attorneys it averages 3.65 to 1 in federal courts and 4.94 to 1 in state courts).

37. *See id.* at 90, 102, 104 (noting the events of a case as being the most important variable affecting a lawyer's time, and finding that each side's lawyers spent an average of 30.4 hours per case, and that a trial adds, on average, 6.7 hours).

38. On average, if a defendant pays less than $10,000 to a plaintiff, he will have to pay an additional one-third (if in state court) or 85% (if in federal court) to compensate his own lawyers. *See id.* at 121 n.85.

Thus, as a practical matter, legal expenses play a significant role in tort law deterrence.[39] For a defendant, the threat of a lawsuit includes an outlay not only to the victim, but also to the defendant's lawyers. For a plaintiff, the decision whether to file a suit requires a weighing of the expected benefits and anticipated expenses of litigation. If plaintiffs refrain from filing meritorious suits, or else settle meritorious suits for less than their merits warrant, defendants who should be liable will escape liability, and tort law deterrence will be dampened. However, as Part III will explore, a plaintiff's ability to pay his lawyer a contingent fee, rather than an hourly fee, may avoid this outcome. Contingent-fee arrangements enable plaintiffs to avoid both the problem of paying legal bills in advance of a verdict or settlement and the risk of losing money in the event they lose the suit.[40]

The importance of legal fees in tort law deterrence, however, extends beyond the defendant's anticipated expenses and the plaintiff's decision to initiate litigation. The costs of litigation also play a major role in the dynamics of settlement. Fewer than ten percent of lawsuits result in trials, and many legal disputes are dropped or settled before a complaint is ever filed.[41] In practice, then, deterrence results not only from a defendant's fear of paying a judgment after trial, but also (and primarily) from the fear of paying a monetary settlement prior to trial.[42]

The basic dynamics of litigation and settlement have been thoroughly explored in law and economics scholarship.[43] The economic analysis of settlement dynamics assumes that each party pays his attorney an hourly fee,[44] so that further

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39. The theoretical question of whether litigation expenses should be internalized along with the costs of accidents is addressed *infra* in Part IV.D.

40. *See, e.g.*, Murray L. Schwartz & Daniel J.B. Mitchell, *An Economic Analysis of the Contingent Fee in Personal-Injury Litigation*, 22 STAN. L. REV. 1125, 1125-26 (1970). Sociological factors may nevertheless affect a plaintiff's decision to sue. *See* Galanter, *supra* note 1, at 14 ("[H]igher income and white households perceive more problems with the goods they buy and complain more both to sellers and to third parties than do poor or black households."). The desire to maintain good continuing relations with a potential defendant may also affect an injured person's (or business's) decision to sue.

41. *See* Galanter, *supra* note 1, at 11-32. Although only about five percent of federal cases reach trial, another quarter are disposed of by pretrial motions. *See* Stephen C. Yeazell, *The Misunderstood Consequences of Modern Civil Process*, 1994 WIS. L. REV. 631, 636-37 & n.19 ("[J]udges are finally disposing of about a third of their civil cases.") (citing DIVISION OF ANALYSIS AND REPORTS, ADMIN. OFFICE OF THE U.S. COURTS, SUMMARY OF CIVIL CASES TERMINATED FROM JULY 1, 1989 TO JUNE 30, 1990).

42. *Cf.* A. Mitchell Polinsky & Daniel L. Rubinfeld, *The Deterrent Effects of Settlements and Trials*, 8 INT'L REV. L. & ECON. 109, 110 (1988) (arguing that settlements and trials have different deterrent effects because defendants pay less for settlements).

43. *See, e.g.*, George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984); Steven Shavell, *Suit, Settlement and Trial: A Theoretical Analysis Under Alternative Methods for Allocation of Legal Costs*, 11 J. LEGAL STUD. 55 (1982); *see also* William M. Landes, *An Economic Analysis of the Courts*, 14 J.L. & ECON. 61 (1971) (discussing settlement dynamics in criminal law).

44. The effect of contingent fees on this analysis is reserved for Part III.

litigation is costly.[45] The theory is that parties will choose to settle a case when their expectations regarding the verdict differ by less than their combined expected legal fees. For example, if the plaintiff expects a jury verdict of $5000 and additional legal expenses of $500, and the defendant expects a jury verdict of $4000 and additional legal expenses of $1000, then the plaintiff would have an incentive to settle for any amount greater than $4500 ($5000 minus $500) and the defendant would have an incentive to settle for any amount under $5000 ($4000 plus $1000). Within the "settlement range" from $4500 to $5000, each party will bargain to try to obtain a greater share of the $500 surplus value that they stand to gain collectively by settling rather than going to trial. (Indeed, such haggling over the surplus value means the parties do not settle in every instance where it would be efficient to do so.)

A general increase in expected legal expenses would lead defendants to offer more and plaintiffs to accept less (because going to trial would be more costly). And, the greater their combined expected legal expenses, the more likely it is that a plaintiff and a defendant will settle despite significant differences over the merits of the case. In fact, so long as their combined expected legal fees (say $5200) exceed the plaintiff's expected jury verdict (say $5000), they should be able to reach a settlement even if the defendant views the case as meritless (i.e., worth $0).[46]

Empirical evidence confirms that this possibility is far from remote. For example, one survey found that in federal cases where the plaintiff ultimately recovered less than $10,000, the defendant paid attorneys' fees equal to 85% of the amount paid to plaintiff.[47] If plaintiffs' attorneys in these cases received on average a contingent fee of 33%, then the parties' total fees would generally exceed the average plaintiff's recovery.[48] This evidence suggests that there is a large subset of cases in which the parties will base settlements almost exclusively upon legal fees, without regard to the underlying merits.[49] Anecdotal evidence

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45. The analysis changes when one considers the reality that most tort plaintiffs pay their lawyers a contingent fee, and that it is these attorneys, rather than the plaintiffs themselves, who bear the additional costs of going to trial if a case is not settled. *See, e.g.*, Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 J. LEGAL STUD. 189 (1987).

46. See *infra* Part III.D for a detailed analysis of a plaintiff's incentive to file and a defendant's incentive to settle a meritless lawsuit.

47. *See* Trubek et al., *supra* note 5, at 121 n.85. Presumably, a large portion of these cases were ones where the potential damage award was much larger than the ultimate settlement amount, but where the plaintiff was likely to lose. The "amount in controversy" requirement for diversity jurisdiction (more than $10,000 when Trubek's article was written) suggests that, at least in the diversity cases, the original complaints sought more than the amount ($10,000 or less) that was ultimately recovered. *See* 28 U.S.C. § 1332 (1988) (current version at 28 U.S.C.A. § 1332 (West Supp. 1997)).

48. *See* Trubek et al., *supra* note 5, at 121 n.85.

49. Part III.B discusses how contingent-fee arrangements may cause future litigation expenses to have different effects on plaintiffs' and defendants' settlement incentives.

further supports the proposition that the expense of litigation leads defendants to settle cases they view as meritless.[50]

Scholars and practitioners alike have focused on two features of our system of litigation—liberal discovery and the absence of fee shifting—that lead litigation costs, and thus settlement amounts, to fail to correspond to a case's underlying merits. In exploring the effects of liberal discovery and non-fee-shifting rules, it is important to keep in mind the basic dynamics of litigation and settlement noted above: plaintiffs decide to sue, and parties decide to settle, based upon their expectations regarding both the likely verdict and the costs of obtaining a verdict. Procedural rules can alter the relative importance of each by influencing the size of expected legal fees relative to the size of the likely verdict, and by determining who shall bear and control those fees. Ultimately, discovery and fee-shifting rules affect what a defendant expects to pay for its conduct in four different ways: (1) if a case proceeds to trial, the defendant will pay pretrial and trial expenses; (2) if a case settles, the settlement amount will reflect some of the legal expenses that the defendant has saved by avoiding trial; (3) even if a case settles, the defendant nevertheless will incur some presettlement legal expenses; but (4) the cost of litigation may inhibit some plaintiffs from filing suits in the first place and may encourage others to accept settlements below their expected verdicts (just as it induces defendants to pay more than their expected verdicts). The literature on discovery and fee shifting explored below helps to explain why American litigation is unreasonably costly, but it does not say whether these costs ultimately burden or benefit defendants.

B. Control over Legal Fees

Tort theory postulates that so long as potential defendants can predict the injuries they are likely to inflict, they should take reasonable safety precautions.[51] In reality, however, the amount that someone must expect to pay for an injury depends not just on the injury itself, but also on the costs of litigation. Furthermore, a defendant's expected litigation costs will not necessarily depend upon the anticipated injuries.

Legal fees constitute the vast bulk of both parties' litigation expenses,[52] and hourly attorneys report that the most important factors affecting their time on a case are (in descending order of importance): (1) the events in the case (principally, the extent of motions and discovery); (2) the type of court (federal being more expensive than state);[53] (3) the client's goals; (4) the lawyer's goals

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50. *See, e.g.*, Galanter, *supra* note 1, at 10-11 & nn.30-37 (citing media reports of meritless law suits). Part III.D discusses in greater detail plaintiffs' incentives to file (or forego) and defendants' incentives to settle (or litigate) meritless lawsuits.

51. *See supra* Part I.

52. *See* Trubek et al., *supra* note 5, at 91 (reporting that "[p]ayments to lawyers constitute[] 99% of out-of-pocket litigation expenses for individual clients and 98% for organizations").

53. Higher legal fees in federal court may be attributable, in part, to: (1) the "amount in controversy" requirement for diversity actions, *see* 28 U.S.C. § 1332 (1994), which may lead to higher average damages demands in federal court, (2) the time spent litigating federal court jurisdiction (removal and remand), and (3) the extra time required to fulfill the potentially

(e.g., professional visibility); and (5) the case's characteristics (stakes and complexity).[54] Accordingly, even if a potential defendant can predict and control the type of injury he may inflict, this information will rank only *fifth* in importance in determining the legal costs he is likely to pay. The defendant may be able to influence the other factors to some extent: his own goals are within his control, as are those of the lawyer he retains. He may also be able to anticipate being sued in federal court, based upon the nature of the offense he will commit (subject matter jurisdiction) or the location of his potential victims (diversity jurisdiction).[55] However, the most important factor affecting the defendant's legal costs—the extent of motions and discovery—are at least equally under the control of the plaintiff.[56] Accordingly, a defendant's expected legal costs may depend as much upon litigation tactics of opposing counsel as upon the anticipated injury.

Putting aside their cost, both liberal discovery and motion practice tend to promote the accurate resolution of legal disputes and to foster settlements that focus upon the merits of a case. Therefore, discovery and motion practice should lead defendants to base their expectations regarding liability upon the relevant substantive law.[57] Discovery and motions practice [58]can be quite expensive, however, and the costs of discovery, in particular, are a popular subject of discussion among practitioners, politicians, and scholars.[59] Law and economics

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higher expectations of federal judges.

54. *See* Trubek et al., *supra* note 5, at 102.

55. A plaintiff can always avoid removal on diversity grounds, however, by filing a suit in the defendant's home state. *See* 28 U.S.C § 1441(b) (1994). Of course, the choice of federal or state court, and of the locality of the suit, may bear upon the finder of fact's likely verdict, as well as upon the costs of litigation. Parties may therefore choose fora in the hope that the choice of a particular forum will improve their chances of winning.

56. It should be noted that contingent-fee plaintiffs' attorneys reported allocating their time based upon (1) the events of the case, and (2) the case's characteristics. *See* Trubek et al., *supra* note 5, at 104, 108. To the extent that the defendant's attorney's fees will depend upon the time spent by the plaintiff's lawyers (in filing motions and discovery requests), the case's characteristics ultimately will have a greater impact upon the defense lawyer's time than is reflected in its ranking of fifth.

57. *But cf.* George Loewenstein et al., *Self-Serving Assessments of Fairness and Pretrial Bargaining*, 22 J. LEGAL STUD. 135, 158-59 (1993) (noting that the psychological tendency to view information with a self-serving bias may undermine discovery's effectiveness as a tool to promote settlement).

58. Less attention has been devoted to the parties' respective abilities to inflict legal costs on one another through motion practice, and in particular, to the unequal time it may take to respond to an opponent's motion. One study has found, however, that while all attorneys spend time responding to their opponent's briefs, contingent-fee attorneys (predominately for plaintiffs) spend half as much time as do hourly attorneys (typically their opponents). *See* Herbert M. Kritzer et al., *The Impact of Fee Arrangement on Lawyer Effort*, L. & SOC'Y REV. 251, 271 (1985). As this difference between plaintiffs' and defendants' attorneys is largely attributable to contingent fees, it is reserved for discussion *infra* in Part III.

59. *See* sources cited *supra* note 2. Discovery is one of the more important factors affecting legal costs. *See* Carl Tobias, *Executive Branch Civil Justice Reform*, 42 AM. U. L. REV. 1521, 1544 (1993) (quoting Chief Judge Robert Parker, the Chair of the Judicial Conference Committee on Court Administration and Case Management, who claimed that excessive discovery was the single greatest factor contributing to unacceptable cost); Trubek et al., *supra* note 5, at 91 (indicating that lawyers on average spend 16.7% of their time on discovery, a

scholarship has worked out in detail the basic reasons for why discovery costs are unreasonably high.[60] First, each party can improve its settlement position by increasing its opponent's anticipated legal costs.[61] As noted above, the greater the anticipated legal expense, the more eager a party will be to settle. Second, because it takes more time to comply with a discovery request than to make such a request, each party can inflict extra expense upon its opponent by making broad discovery requests.[62] Third, the Federal Rules of Civil Procedure and state rules of procedure do not shift the costs of compliance to the party requesting discovery.[63] A party thus can improve its settlement position by making burdensome discovery requests, even if the information it hopes to gain is of little advantage.

The overall costs of discovery may therefore exceed the overall benefits,[64] as each party gains not only from the information it receives through discovery, but also from the legal costs that discovery requests impose upon an opponent. Moreover, even where discovery is honestly intended to obtain information, and not to burden the opponent, a party nevertheless may make requests that are not cost justified, that is, requests it would not choose to make were it to bear the costs of compliance.[65] Each party simply lacks incentives to weigh the costs and benefits of its discovery requests because these costs are not internalized.[66]

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percentage greater than that spent on any other single activity).

60. *See, e.g.*, Robert D. Cooter & Daniel L. Rubinfeld, *An Economic Model of Legal Discovery*, 23 J. LEGAL STUD. 435 (1994); Bruce L. Hay, *Civil Discovery: Its Effects and Optimal Scope*, 23 J. LEGAL STUD. 481 (1994); Note, *Discovery Abuse Under the Federal Rules: Causes and Cures*, 92 YALE L.J. 352 (1982).

61. *See supra* Part II.A.

62. This is true of document productions and interrogatories. On the other hand, a lawyer taking a deposition may spend more time preparing than does the lawyer defending it. Also, if the deposed witness is an employee of one of the parties, the employee's time must be included in the costs of compliance.

63. *See generally* FED. R. CIV. P. 26-37 (discovery rules); Edward F. Sherman, *A Process Model and Agenda for Civil Justice Reforms in the States*, 46 STAN. L. REV. 1553, 1566-70 (1994) (comparing reform possibilities for discovery in state and federal courts).

64. Bruce Hay points out that private incentives and social incentives may differ, and that even if a discovery request does not increase the value of the requesting party's claim sufficiently to justify its cost, the request may nevertheless be socially efficient if it induces defendants to take precautions against inflicting harm. *See* Hay, *supra* note 60, at 483. Hay goes on to explain, however, that fine-tuning discovery rules in order to achieve a socially optimal level of discovery is quite difficult: "A rule allowing an apparently ideal amount of discovery may backfire if it leads the parties to settle without undertaking discovery." *Id.* at 514.

65. Cooter and Rubinfeld distinguish between discovery "misuse," which occurs "when compliance costs more than the expected increase in the value of the requesting party's claim," and "abuse," which they define as *knowing* "misuse." Cooter & Rubinfeld, *supra* note 60, at 437.

66. Surveys have found widespread dissatisfaction with the costs of discovery. *See, e.g.*, LOUIS HARRIS & ASSOCS., INC., PROCEDURAL REFORM OF THE CIVIL JUSTICE SYSTEM at iv (1989). However, several scholars have questioned the accuracy of the belief shared by politicians, corporations, the media, the public, and even lawyers and judges that discovery abuse pervades our system of litigation. *See, e.g.*, Mullenix, *supra* note 1, at 1396; Paul R. Sugarman & Marc G. Perlin, *Proposed Changes to Discovery Rules in Aid of "Tort Reform":*

Discovery is supposed to be kept in check by each party's fear that if it makes unduly burdensome requests, the other side will either obtain sanctions under Federal Rule of Civil Procedure 26(g) or retaliate with its own burdensome requests. In practice, however, the imposition of discovery sanctions is highly unusual and generally is triggered only by knowingly and patently abusive requests that are intended to impose costs rather than to obtain needed information.[67] Moreover, the threat of retaliation often does not limit discovery until it has already exceeded reasonable levels; it may take several rounds of escalated discovery requests before the parties try to reach a genuine agreement to limit discovery.[68]

Our discovery rules, then, increase litigation costs by providing neither incentives nor adequate court supervision to ensure that discovery requests are cost justified.[69] Of course, the prospect of unreasonably high discovery costs

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Has the Case Been Made?, 42 AM. U. L. REV. 1465, 1469 (1993). For purposes of this Article, it is unimportant whether parties are purposely abusing discovery in order to improve their settlement positions, or are innocently engaging in excessive discovery because the rules provide inadequate economic incentives for them to refrain from doing so. The Article's aim is simply to discuss how discovery rules may affect the amount that potential defendants expect to pay for their conduct (i.e., by influencing the rate at which plaintiffs file and litigate lawsuits, and the amount it costs defendants to defend and settle them).

67. Federal Rule of Civil Procedure 26(g)(2)(C) provides that requests not be "unreasonable or unduly burdensome or expensive, given the needs of the case, the discovery already had in the case, and the amount in controversy, and the importance of issues at stake in the litigation." FED. R. CIV. P. 26(g)(2)(C). In practice, however, this rule is rarely enforced, particularly in cases where the requesting party honestly intends to obtain information, and merely neglects to consider the costs that will be borne by his opponent. *See* C. RONALD ELLINGTON, A STUDY OF SANCTIONS FOR DISCOVERY ABUSE 96-102 (1978); 8 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE, § 2052, at 630 (2d ed. 1994); Wayne D. Brazil, *Views from the Front Lines: Observations by Chicago Lawyers About the System of Civil Discovery*, 1980 AM. B. FOUND. RES. J. 217, 245.

> To succeed in reducing substantially the costs of litigation, one must identify the practices and rules that encourage discovery abuse, and modify them to encourage responsibly limited discovery. Well-intentioned directives, threats of punishment, and calls for less adversary behavior can have no significant effect upon the underlying causes of discovery abuse.

Abraham D. Sofaer, *Sanctioning Attorneys for Discovery Abuse Under the New Federal Rules: On the Limited Utility of Punishment*, 57 ST. JOHN'S L. REV. 680, 720 (1983).

68. The 1993 amendments to the Federal Rules of Civil Procedure discarded the provision, previously contained in Federal Rule of Civil Procedure 26(f), that upon either party's motion, the judge must schedule a conference and issue a discovery plan "setting limitations on discovery, if any." FED. R. CIV. P. 26(f) (prior to 1993 amendment).

69. The 1993 amendments to the Federal Rules of Civil Procedure included significant amendments to the rules governing discovery. *See generally* DONNA STEINSTRA, FEDERAL JUDICIAL CTR., IMPLEMENTATION OF DISCLOSURE IN FEDERAL DISTRICT COURTS, WITH SPECIFIC ATTENTION TO COURTS' RESPONSES TO SELECTED AMENDMENTS IN FEDERAL RULE OF CIVIL PROCEDURE 26 (1994). First, "[e]xcept to the extent otherwise stipulated or directed by order or local rule," the rules now require automatic disclosure of discoverable information "relevant to disputed facts alleged with particularity in the pleadings." FED. R. CIV. P. 26(a)(1). Second, the new rules set presumptive limits on the numbers of depositions (10) and interrogatories (25) that a party may request without leave of the court. *See* FED. R. CIV. P. 30(a)(2)(A),

might lead parties to settle some cases *prior to* discovery.[70] In such cases, the plaintiff and defendant would settle based upon prediscovery estimates of the value of a case. In theory, if the parties agreed on the case's value (and did not engage in strategic behavior) they could avoid entirely the costs of discovery and could settle the case for its estimated value. Thus, in theory, the flaws in our system of discovery outlined above would not skew deterrence at all. The prospect of high discovery costs would not inhibit plaintiffs from filing meritorious suits, since plaintiffs would expect to avoid those costs by settling early. Likewise, defendants would expect to avoid high discovery costs by settling early. Accordingly, defendants would expect to settle suits for the fair value of the injuries in question.

Unfortunately, this hypothetical scenario—in which the parties agree upon a case's value *before* discovery and thereby save the costs of discovery—is unlikely to arise in practice. One of discovery's most basic purposes is to enable the parties to evaluate the merits of a case. Discovery's free exchange of information increases the likelihood that parties will view a case similarly. Accordingly, before discovery, the parties will be less likely to agree on a case's merits. As a result, either of the following two scenarios is more likely to arise in practice than the hypothetical scenario described above.

First, the parties may devote significant resources to discovery *before* they can reach a settlement. (As noted above, the rules governing discovery are such that the parties do not have incentives to keep this discovery within reasonable limits.[71]) To the extent that plaintiffs and defendants anticipate paying significant litigation costs before settling, deterrence incentives may be skewed: anticipated costs may inhibit plaintiffs from filing meritorious cases in the first place, thereby allowing defendants that should be liable to avoid any penalty; or, if plaintiffs do file suit, defendants will expect to pay significant litigation expenses on top of settlement amounts, even with regard to meritless cases.

Alternatively, the parties may decide that, despite significant disagreement over the merits, they nevertheless will settle before discovery because their expected litigation costs are so large as to exceed the difference between their expected verdicts. This will not, however, ensure accurate deterrence. To settle despite wide disagreement, the defendant and the plaintiff must depart significantly from their views of the merits—paying higher and receiving lower settlements, respectively, than they believe the merits warrant. Unlike the hypothetical parties

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31(a)(2)(A), 33(a). However, about half of the federal districts have opted out of these new rules under Rule 26(b)(2). *See* Mullenix, *supra* note 1, at 1444 (observing that 48 out of 94 districts have opted out) (citing *New Discovery Rules*, 62 U.S.L.W. 2449, 2450 (Jan. 25, 1994)). Moreover, the new rules do not limit requests for document production, a discovery device that can be quite costly.

70. *See* Hay, *supra* note 60, at 510.

71. It is worth noting that where a case does not settle, the costs of pretrial activities, such as discovery and settlement negotiations, generally exceed the costs of trial. *See* Trubek et al., *supra* note 5, at 91, 104 (noting that in cases that proceed to trial, attorneys spend less than 10% of their time preparing for and attending the trial). Accordingly, even if liberal discovery is credited with increasing settlement rates, it is unlikely that the saved trial expenses would exceed the unreasonably high costs of discovery described in the text above.

above, who each believed he could save litigation costs entirely by settling, parties who disagree about a case's value, but settle anyway to save large litigation costs, will believe that they have borne, rather than saved, the greater part of litigation costs. And, if plaintiffs and defendants both expect ex ante to settle cases ex post for amounts that do not reflect their true value, deterrence may be skewed: defendants will expect plaintiffs to forego meritorious cases[72] and will expect to pay too much for meritless ones.

Of course, where the parties disagree so significantly, and each believes that he has settled for an unfair amount simply to avoid litigation costs, the parties' divergent predictions regarding the verdict cannot both be correct. Although both parties may believe that they have borne litigation costs (by settling for an unfair amount), *in reality* they will have saved those costs.[73] These saved costs will not, however, automatically result in *accurate* settlements. Where parties disagree significantly over the merits, the settlement process will move them toward a middle point determined as much by their future legal expenses (i.e., who is more reluctant to proceed) and their relative bargaining strengths, as by the merits of their positions. Resulting settlements are likely to be too high or too low.[74]

Returning to defendants' ex ante incentives, if litigation expenses and bargaining power drive litigation and settlement decisions, with the legal merits playing a secondary role, then defendants may either expect to pay too little for their conduct (if plaintiffs forego meritorious suits or settle for too little) or else to pay too much for their conduct (if they expect to be sued and to pay excessive settlements). In sum, whether the parties choose to settle early or to litigate fully, America's discovery rules may skew deterrence incentives by substituting expenses for merits as the driving force behind litigation and settlement dynamics.

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72. True, the prospect of settling a case for a profit, albeit for less than it is worth, should not inhibit plaintiffs from filing lawsuits. However, in deciding whether to file a lawsuit, plaintiffs must weigh the likelihood of several different possible outcomes, including winning or losing a jury verdict, or obtaining a large or small settlement. To the extent that plaintiffs expect the prospect of high litigation costs to force them to accept lower settlements, this may alter their calculus and lead them to forego some meritorious lawsuits, which will ultimately allow some liable defendants to escape responsibility. Of course the availability of contingent-fee arrangements discussed in Part II will affect this analysis.

73. Of course, lawyers working for a contingent fee still get paid. *See* discussion *infra* Part III (addressing the effect of contingent-fee arrangements, which typically provide for a percentage of the plaintiff's recovery regardless of when the case settles, on the parties' behavior).

74. *See* Brazil, *supra* note 67, at 225 (noting empirical evidence that "the projected expense of responding to and conducting discovery more than occasionally pressured [attorneys] to advise a client to accept a settlement even though they knew the case was underdeveloped and even though they suspected that an opponent possessed relevant information that they had not yet discovered").

C. Fee Shifting

This effect of liberal discovery, however, and the dynamics of litigation and settlement described thus far, depend upon a second American rule that requires each party to bear its own legal fees.[75] If implemented in the United States, fee shifting would change the dynamics of litigation and settlement.[76]

Most obviously, a fee-shifting rule (such as prevails in the English system) largely eliminates the disjunction between the costs of a lawsuit to a defendant and the likelihood of winning at trial, as the defendant pays nothing at all if he wins. The prospect of fee shifting also alters settlement dynamics. As noted above, parties will settle as long as their verdict estimates differ by less than their expected legal fees, so that the saved costs of avoiding a trial exceed the expected return of going to trial.[77] In a fee-shifting regime, however, if the plaintiff and the defendant disagree over the likely verdict, this difference will be reflected in their expected legal fees as well.[78] Accordingly, any gap between their settlement positions will widen.[79] In the anticipation of recouping the costs of continued

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75. Some statutory exceptions to this rule are designed to encourage the filing of lawsuits. *See, e.g.*, 42 U.S.C. § 1988(b) (1994) (providing for one-way fee shifting in favor of prevailing civil rights plaintiffs); CAL. CIV. PROC. CODE § 1021.5 (1980) (same).

76. *See, e.g.*, John C. Hause, *Indemnity, Settlement, and Litigation, or I'll Be Suing You*, 18 J. LEGAL STUD. 157 (1989); Avery Katz, *Measuring the Demand for Litigation: Is the English Rule Really Cheaper?*, 3 J.L. ECON. & ORG. 143 (1987); Shavell, *supra* note 43; Bradley L. Smith, Note, *Three Attorney Fee-Shifting Rules and Contingency Fees: Their Impact on Settlement Incentives*, 90 MICH. L. REV. 2154 (1992). This latter note deals with two of the three cost-related procedures addressed by this Article.

For general discussions of the English and American rules, see, for example, Thomas D. Rowe, Jr., *Predicting the Effects of Attorney Fee Shifting*, LAW & CONTEMP. PROBS., Winter 1984, at 139 [hereinafter *Predicting the Effects*] (summarizing major likely effects of fee shifting); Thomas D. Rowe, Jr., *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 DUKE L.J. 651; Murray L. Schwartz, *Foreword*, LAW & CONTEMP. PROBS., Winter 1984, at 1 (introducing symposium on fee shifting that includes articles on the history of the American rule, on comparisons to Canadian and European systems, and on the effects of fee shifting on litigants' incentives); John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 AM. U. L. REV. 1567 (1993).

For a discussion of a fee-shifting rule based upon the strength of a claim, rather than simply upon whether it prevails, see Lucian Arye Bebchuk & Howard F. Chang, *An Analysis of Fee Shifting Based on the Margin of Victory: On Frivolous Suits, Meritorious Suits, and the Role of Rule 11*, 25 J. LEGAL STUD. 371 (1996). Bebchuk and Chang's article is discussed *infra* in Part V.

77. *See* discussion *supra* Part II.A.

78. *See* Shavell, *supra* note 43, at 64-65.

79. For simplicity, consider a lawsuit in which the amount of the victim's damages (say, $10,000) is clear and the only disagreement is over liability. Further assume that each party believes that it has a 60% chance of prevailing (i.e., the plaintiff believes there is a 60% chance, and the defendant believes there is a 40% chance, that the plaintiff will prevail). If the plaintiff's and the defendant's expected costs of going to trial are $1200 each, then in the American system the parties should settle, since the saved costs of going to trial ($1200 + $1200 = $2400), would exceed the $2000 difference in their expected jury verdicts (60% of $10,000, or $6000, versus 40% of $10,000, or $4000). Looking at each side individually, the

litigation, optimistic parties can refrain from settling a lawsuit for amounts they would otherwise accept in a non-fee-shifting regime. And, plaintiffs deciding whether to file lawsuits in the first place will know ex ante that optimistic defendants will be more willing to proceed to trial (and to spend more with the expectation of recouping litigation expenses).[80] Indeed, from the outset, fee-shifting systems encourage stronger lawsuits, and discourage weaker ones, by rewarding victorious claims and imposing a penalty for those that lose.[81] In theory, then, a potential defendant's total tort payments should depend more upon substantive law in a fee-shifting regime than it would in an American system where each party bears its own legal fees.[82]

A related rule regarding offers of settlement likewise ensures that merits play a primary role in settlement and litigation dynamics where there is doubt not only

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plaintiff would be willing to settle for an amount exceeding $4800 (his $6000 expected verdict minus $1200 saved legal costs) and the defendant would be willing to settle for up to $5200 (his $4000 expected verdict plus $1200 saved legal costs). Under the English system, however, the plaintiff would expect to receive $10,000 and pay nothing if he wins (an outcome that he expects is 60% likely) and to receive nothing and pay both parties' legal costs of $2400 if he loses (an outcome that he expects is 40% likely). Accordingly, the plaintiff's expected gain from going to trial would be $6000 (60% of $10,000) minus $960 (40% of $2400), or $5040. The defendant would expect to pay nothing if he wins (which he views as 60% likely), and to pay a $10,000 verdict plus both parties' legal costs of $2400 if he loses (which he views as 40% likely). Accordingly, the defendant's expected loss from going to trial is $4960 (40% of $12,400). In theory, then, the parties will not settle, as the lowest amount the plaintiff would be willing to accept ($5040) is greater than the highest amount that the defendant would be willing to pay ($4960) to avoid trial.

80. Because the English fee-shifting rule increases the stakes of winning or losing a lawsuit, it will encourage both parties to spend more money trying to win a case, and will especially encourage the party with the stronger case to spend more (in the hope of winning reimbursement from his opponent). *See* Hause, *supra* note 76, at 158, 167-68; Katz, *supra* note 76, at 144; Smith, *supra* note 76, at 2155. This additional spending, by increasing the costs of not settling, may actually make settlement more likely under the English rule than under the American rule, even though the English rule otherwise tends to widen the gap between the parties' settlement positions. *See* Hause, *supra* note 76, at 172; Katz, *supra* note 76, at 144; Smith, *supra* note 76, at 2155.

81. *See* Rowe, *Predicting the Effects*, *supra* note 76, at 152; Shavell, *supra* note 43, at 59. Moreover, a plaintiff deciding whether to file a weak lawsuit will know not only that he must bear the defendant's legal costs if he loses, but also that the defendant will spend more to defend the case. The defendant's increased efforts may further hurt the plaintiff's (already weak) chances of winning, in addition to increasing the plaintiff's likely expenses if he ultimately does lose. *See* Hause, *supra* note 76, at 168.

82. Risk aversion, however, may complicate the above analysis, changing the rate at which plaintiffs file meritorious and meritless lawsuits under the English fee-shifting rule. *See* Shavell, *supra* note 43, at 62; *cf.* Bebchuk & Chang, *supra* note 76, at 378-80 (discussing effect of uncertainty on plaintiff's incentives under American and English rules). While risk aversion may lead plaintiffs to forego meritorious lawsuits even under an American rule, the English fee-shifting rule aggravates this problem. By guaranteeing the prevailing plaintiff a higher recovery, and the losing plaintiff a greater loss, the English fee-shifting rule increases the stakes of litigation. The fear of paying their opponents' legal fees, in addition to their own, may lead risk-averse plaintiffs to forego suits they would otherwise file under the American system. Because contingent-fee arrangements help plaintiffs to manage litigation risk, a more complete discussion of the effects of risk aversion is reserved for Part III, *infra*.

about who will win, but also about the size of damages. By making the plaintiff bear all postoffer legal fees if the verdict falls short of the defendant's settlement offer, the English system enables a defendant that is willing to pay the true cost of the injury in question to avoid exorbitant legal fees.[83] Indeed, when evaluating the costs and benefits of a risky activity ex ante, if the defendant is able to predict the injuries that he may cause, he need not speculate further on the legal fees he might incur to litigate and settle lawsuits based on such injuries.

The ability of a fee-shifting rule to focus the parties on the merits underscores the failure of the American system to encourage accurate settlements. By refusing to shift attorneys' fees, the U.S. system of litigation forces parties to bear litigation expenses without regard to the merits. Moreover, in calculating anticipated legal fees, parties must take into account the power (described above) that opponents have to escalate these fees through discovery requests and motion practice. Because the United States has chosen *both* to allow liberal discovery without providing close court supervision or private incentives to reduce costs, *and* to deny the prevailing party any reimbursement for legal fees from the losing party, each litigant must face unreasonably high litigation costs that are beyond its control, regardless of the merits of its position.

Although these characteristics of American litigation may skew deterrence, America's approaches to discovery and fee shifting do not alone guarantee that deterrence will be skewed in any particular direction. In some instances, high litigation costs could lead plaintiffs to forego meritorious claims or to settle them for too little, and thereby allow defendants to escape responsibility where they should be liable.[84] In other instances, where plaintiffs decide to sue and to reject low settlement offers, America's litigation rules may lead defendants to pay more for their conduct than they would in a costless system of litigation, and to pay significant amounts for weak, and even meritless, cases. Unfortunately, a third subset of cases—those in which defendants pay exactly what the merits warrant—is likely to be quite small. This is true because, as noted earlier, parties are less likely to agree on a case's merits before discovery, and thereby will have difficulty settling early and sharing the saved costs of litigation. Even if the parties do settle before conducting expensive discovery, the resulting settlement

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83. A defendant need only pay in to the court the amount it is offering in settlement. *See* HAZEL GENN, HARD BARGAINING 111 (1987); Vargo, *supra* note 76, at 1611. Regarding proposals to apply a similar rule to settlement offers in the United States, see *infra* Part V (discussing David A. Anderson, *Improving Settlement Devices: Rule 68 and Beyond*, 23 J. LEGAL STUD. 225 (1994), and Geoffrey P. Miller, *An Economic Analysis of Rule 68*, 15 J. LEGAL STUD. 93 (1986)).

84. *See* Polinsky & Rubinfeld, *supra* note 42, at 112 ("Because litigation is costly, not every individual who suffers harm will bring suit."). Under Polinsky and Rubenfeld's model, settlements result in underdeterrence if litigation expenses lead plaintiffs to forego meritorious suits and/or defendants pay less than victims' injuries. *See id.* at 109-10. The analysis in Part III *infra* of the combined effect of discovery rules, non-fee-shifting, and contingent-fee arrangements essentially explains why these assumptions do not hold true: contingent-fee attorneys do accept and litigate even small cases where the costs of litigating to trial outweigh the expected verdict, *see infra* Part III.A, and plaintiffs' bargaining power is sufficiently strong to ensure that defendants' settlement payments together with their presettlement litigation expenses do not generally fall short of plaintiffs' injuries, *see infra* Part III.B-C.

may strike a random compromise based on bargaining power and future legal expenses, rather than reflect accurately the merits of a case. Accordingly, because early settlements are likely to be too high or low, they do not ensure accurate deterrence.

III. THE AVAILABILITY OF CONTINGENT-FEE ARRANGEMENTS

Although liberal discovery and non-fee-shifting rules lead to unreasonably high litigation costs that are beyond a party's control, and that the parties must be bear regardless of the merits, they do not inherently lead defendants to expect to pay more or less for their conduct than they would under substantive law alone. As noted above, the ultimate cost to defendants will depend on whether plaintiffs pursue or forego litigation and on the parties' relative bargaining strengths and litigation costs. The discussion below demonstrates that each of these factors depends on whether the plaintiff is permitted to pay his attorney a contingent, as opposed to an hourly, fee. When contingent-fee arrangements are added into the mix, it becomes clear that defendants do indeed pay more for tort suits than their collective merits warrant.

In America, but not in England, a client may pay his lawyer a percentage fee that is contingent upon the success of the case.[85] The availability of contingent-fee arrangements influences the rate at which plaintiffs file tort claims, the bargaining power plaintiffs bring to settlement negotiations, and the ability of an attorney-client team to handle unreasonably high litigation expenses. The discussion below first addresses the possibility of underdeterrence—that is, a potential defendant's expectation of escaping liability for meritorious lawsuits or paying inordinately low settlements. Subparts A and B demonstrate that the availability of contingent-fee arrangements increases both the rate at which plaintiffs file meritorious claims and the amounts for which these claims settle. Subparts C and D then turn to the problem of overdeterrence, demonstrating that in addition to paying for plaintiffs' injuries in meritorious cases, defendants cannot avoid paying both significant presettlement litigation costs in meritorious cases and significant amounts to defend and/or settle meritless suits. Ultimately, when the effects of contingent-fee arrangements are considered together with the effects of the discovery and non-fee-shifting rules outlined above, the result is a litigation system that predictably leads defendants to pay more for their conduct than they would under substantive law alone.

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85. For an argument that contingent fees should be calculated differently, see Lester Brickman, *Contingent Fees Without Contingencies: Hamlet Without the Prince of Denmark?*, 37 UCLA L. REV. 29, 34 (1989) (advocating fee based on "lawyer's anticipated effort; estimated risk of nonrecovery; settlement value of the case; and the risk premium to be added to the lawyer's opportunity cost, to compensate for the risk the lawyer undertakes").

A. Contingent Fees and the Decision to File a Meritorious Lawsuit

Practitioners and scholars generally agree that the availability of contingent-fee arrangements in America increases the rate at which plaintiffs file lawsuits.[86] The basic reasons for this increase are fairly straightforward. First, contingent-fee arrangements eliminate the plaintiff's risk of a financial loss if the suit fails. Second, contingent-fee arrangements eliminate the plaintiff's need to pay a retainer fee or hourly bills in advance of any cash verdict or settlement.[87] As a result, plaintiffs have an incentive to sue whenever they can find an attorney willing to proceed on a contingent-fee basis.

Third, unlike their clients, attorneys can pursue many lawsuits at one time, and spread the risk of losing any particular suit over the sum of lawsuits in their caseload. Thus, attorneys tend to be less risk averse than their clients, and are willing to proceed for a contingent fee in many cases that plaintiffs would otherwise forego.[88]

A system allowing contingent-fee arrangements therefore has the beneficial effect of enabling nonaffluent, risk-averse plaintiffs to file meritorious lawsuits where they otherwise would not.[89] And, such a system therefore reduces the likelihood that a potential tortfeasor will expect to avoid liability despite violating the law.

Indeed, the availability of contingent-fee arrangements may help plaintiffs pursue meritorious suits even more than would a fee-shifting regime.[90] As noted above, in theory, fee-shifting rules should link the expected costs of litigation to the merits of a case, and thereby encourage plaintiffs to file and litigate meritorious lawsuits. However, in practice, the fear of bearing all legal fees may lead a risk-averse party to forego a meritorious claim, or to settle it for an amount that is significantly less than the amount the case would be worth in a costless,

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86. *See, e.g.*, Thomas J. Miceli & Kathleen Segerson, *Contingent Fees for Lawyers: The Impact on Litigation and Accident Prevention*, 20 J. LEGAL STUD. 381, 388 (1991); Miller, *supra* note 5, at 10-11; Vargo, *supra* note 76, at 1617-19.

87. *See, e.g.*, Miceli & Segerson, *supra* note 86, at 388; Vargo, *supra* note 76, at 1618.

88. *See* Samuel R. Gross & Kent D. Syverud, *Getting to No: A Study of Settlement Negotiations and the Selection of Cases for Trial*, 90 MICH. L. REV. 319, 349 (1991).

89. *Cf.* Thomas J. Miceli, *Do Contingent Fees Promote Excessive Litigation?*, 23 J. LEGAL STUD. 211, 223-24 (1994) (suggesting that "it might be accurate to say that hourly fees result in too little litigation, rather than to say that contingent fees result in too much litigation"); Rowe, *Predicting the Effects*, *supra* note 76, at 153.

90. For a discussion of a system that provides both for fee shifting and contingent-fee arrangements, see Smith, *supra* note 76.

accurate legal system.[91] Moreover, most tort plaintiffs, who may already have financial difficulties due to their injuries, tend to be risk averse.[92]

One might question, however, the extent to which a contingent-fee system may induce plaintiffs to file small, meritorious lawsuits. Even if the costs of future litigation are borne by the attorney, rather than the client, will the attorney not be deterred from proceeding when those costs are likely to be high, to be subject to the other party's control, and to be borne regardless of the merits? An attorney will be willing to accept a case for a contingent fee only if he expects his fee of one-third of the recovery[93] to exceed his opportunity cost. If the likely verdict in a case does not exceed three times the value of the time it would take the attorney to litigate the case, the attorney could not hope to profit from a trial. This generally means that the expected return on small cases does not outweigh the attorney's opportunity cost.

However, even where an attorney could not possibly profit by litigating the suit to a verdict, the attorney may nevertheless hope to profit from an early settlement. The question that arises, then, is whether defendants might reasonably be induced to settle small cases. If the defendant knows that the plaintiff's attorney would lose money by litigating the case to its conclusion, the defendant would be wise to "sit tight" and hope that the plaintiff's attorney simply drops the case.[94]

A recent article demonstrates that, because the parties may settle at any point during a lawsuit, a plaintiff's attorney may hope to profit even if the expected verdict would not justify the time it would take him to litigate the suit to a conclusion.[95] For simplicity, consider a hypothetical lawsuit in which everyone agrees that the plaintiff is 75% likely to win an $800 verdict (and otherwise will lose). The case would be worth $200 to a plaintiffs' attorney working for a contingent fee of one-third of any recovery (i.e., one-third of 75% of $800). Further imagine that the litigation process were such that the parties either had to

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91. *See* Vargo, *supra* note 76, at 1609-13 (citing GENN, *supra* note 83, at 98-113, 167-69). In practice, about 99% of English lawsuits are settled before trial. *See id.* at 1612. In America, the settlement rate is thought to be a bit lower. *See, e.g.*, Galanter, *supra* note 1, at 21 (7% of surveyed cases went to trial); Trubek et al., *supra* note 5, at 89 (less than 8% of sample went to trial); *see also* W. Kip Viscusi, *The Determinants of the Disposition of Product Liability Claims and Compensation for Bodily Injury*, 15 J. LEGAL STUD. 321, 329 (1986) (95% of 10,000 products liability suits settled).

92. *See, e.g.*, Gross & Syverud, *supra*, note 88, at 349, 384; Vargo, *supra* note 76, at 1594.

93. Litigation expenses may be paid out of the plaintiff's award either before or after the attorney's one-third fee is calculated. *See* Kevin M. Clermont & John D. Currivan, *Improving on the Contingent Fee*, 63 CORNELL L. REV. 529, 532 n.3 (1978). Even if it is agreed that expenses are to be borne by the client (and to come out of the client's share of the award in case of victory), as a practical matter, attorneys do not seek reimbursement of expenses where the plaintiff receives nothing. *See id.*

94. *See* Lucian Arye Bebchuk, *Suing Solely to Extract a Settlement Offer*, 17 J. LEGAL STUD. 437, 438 (1988).

95. *See* Lucian Arye Bebchuk, *A New Theory Concerning the Credibility and Success of Threats to Sue*, 25 J. LEGAL STUD. 1 (1996). Bebchuk considers plaintiffs' incentives to file, and defendants' incentives to settle, "negative-expected-value" ("NEV") suits (i.e., suits with expected returns to plaintiffs that are lower than the expected costs of litigation). Although the text focuses on small cases, a lawsuit may have a NEV despite large potential damages, if the likelihood of winning is slim and the costs of litigation are high. *See id.* at 1.

settle at the beginning of the lawsuit, or not settle at all—that is, if the defendant refused to settle immediately, the plaintiff's attorney could not hope for a later settlement. Rather he would have to decide either to litigate the case to a verdict or else to drop it. In this hypothetical world, if the plaintiff's attorney expected to devote $300 worth of time to litigate the suit to a conclusion (and the defendant were aware of this cost), the attorney would not reasonably accept the case. He would know that if he did file a complaint, the defendant would wisely refuse to settle at the outset based upon the reasonable expectation that the plaintiff's attorney would drop the case instead of litigating it.[96]

In reality, however, settlement can occur at various points in the litigation. Parties may settle before any complaint is filed, after the pleadings but before any significant discovery, at any time during the discovery process, on the eve of trial, or even in the midst of trial. And, the plaintiff's attorney may be able to induce the defendant to settle at any of these points as long as he can maintain a credible threat to continue with the litigation at all later points.[97] Reconsider the simple hypothetical above, in which the plaintiff's attorney hopes to earn a $200 fee. Now, however, imagine that the parties may settle *either* at the start of the case *or* on the eve of trial. Further imagine that upon receiving the complaint, the defendant can envision (1) that it will cost the plaintiff's attorney $150 worth of time to complete pretrial litigation; and (2) that it will cost the plaintiff's attorney an additional $150 to try the case. Although the total $300 cost to the plaintiff's attorney would not justify the $200 expected fee, the plaintiff's attorney might nevertheless reasonably continue to litigate at each stage, hoping at the outset either to earn a quick $200 profit by settling immediately, or to settle on the eve of trial for a $50 profit, but continuing litigation even if the case does not settle, in the hope of reducing his losses by $50 (from $150 to $100). Because the plaintiff's attorney could reasonably threaten to continue to litigate at each stage, the defendant would be wise to settle early and avoid not only the likelihood of an adverse verdict (worth $600 to him), but also the costs of litigation.

This explanation of why plaintiffs' attorneys would accept small cases for a contingent fee also could explain why plaintiffs who pay their attorneys an hourly fee might hope to profit from small cases.[98] Recall that a plaintiffs' attorney working for a contingent fee, at each stage, must expect to recover three times the value of his future efforts in order credibly to threaten defendants with continued litigation. Where the plaintiff himself, rather than his attorney, bears the costs and benefits of future litigation, he need only expect enough to cover his legal bills—not three times that amount. Accordingly there may be a subset of small cases in which the attorney would refuse to work for a contingent fee, but the plaintiff might hope to profit by paying an hourly fee.

Most tort plaintiffs, however, are unlikely to pursue these cases on an hourly-fee basis. Moreover, even in those cases where the attorney and the client could

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96. *But cf. infra* Part III.D.3 (discussing attorneys' inability to withdraw where client wishes to proceed).

97. *See* Bebchuk, *supra* note 95, at 4.

98. Indeed, Bebchuk's article focuses on plaintiffs' incentives, rather than those of their attorneys. *See id.*

each hope to profit from either type of fee arrangement, the client (1) is likely to choose to pay a contingent fee, and (2) might not proceed at all if contingent-fee arrangements were prohibited. This is because tort plaintiffs are generally more risk averse than their attorneys (who can spread a loss in any particular case over the entirety of their caseloads).[99] Given that the above strategy—threatening continued litigation even where a trial would ultimately result in a loss of money—is a risky one, plaintiffs' attorneys are better equipped than their clients to bear the potential costs of this strategy. Moreover, the strategy's success may require fairly tight control over litigation expenses, so that potential losses are kept to a minimum. Plaintiffs' attorneys clearly have better control than their clients over the resources devoted to litigation.

Ultimately, then, the availability of contingent-fee arrangements increases the rate at which plaintiffs file meritorious lawsuits, both large and small. Granted, there may remain a small subset of meritorious cases that are small but expensive, which will not be filed in the absence of a fee-shifting rule. But, as a general matter, the availability of contingent-fee arrangements alleviates one of the potential problems caused by America's approaches to discovery and fee-shifting. In the absence of contingent-fee arrangements, those two sets of rules would inhibit plaintiffs from filing meritorious lawsuits (for fear of high legal fees, beyond their control, that the parties must bear regardless of the merits). However, America's decision to allow contingent-fee arrangements reduces the number of instances in which plaintiffs forego meritorious lawsuits, and in which at-fault defendants thereby unjustly avoid liability.

B. Contingent Fees and Settlement Dynamics

The prospect of expensive litigation could lead to inadequate deterrence not only by causing plaintiffs to forego meritorious claims, but also by inducing them to accept unduly low settlements. Indeed, because individual tort plaintiffs are typically less affluent and more risk averse than repeat, institutional defendants, one would expect defendants to capture the greater part of any bargaining surplus and to settle cases for less than the merits warrant.[100]

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99. *See* sources cited *supra* notes 86-87 and accompanying text.

100. The fear of paying legal fees, in addition to a judgment, might also lead a risk-averse defendant to settle a case for more than it is worth, but institutional defendants are generally better able to manage risk than are individual plaintiffs. Insurance companies and large corporations that are repeat players can spread the risk of any single lawsuit over the pool of lawsuits to which they are parties. They may be willing to assume the risk of losing some trials, even if that means paying prevailing plaintiffs' attorneys fees, in the hope that they will win some, and achieve advantageous settlements in others. The risk neutrality of a repeat defendant provides it with a bargaining advantage over a plaintiff that is risk averse. *See* Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 L. & SOC'Y REV. 95, 98-102 (1974) (noting imbalance of power between one-shot claimants and repeat defendants, but also that "personal injury cases . . . are distinctive in that free entry to the arena is provided by the contingent fee"); Samuel R. Gross & Kent D. Syverud, *Don't Try: Civil Jury Verdicts in a System Geared to Settlement*, 44 UCLA L. REV. 1, 38 (1996) ("Insurance companies, government, and big business—the true defendants in almost all cases—are repeat players."); Vargo, *supra* note 76, at 1609 (citing GENN, *supra* note 83, at 98-109); *cf.* John C.

Contingent-fee arrangements, however, help to eliminate the possibility of underdeterrence by increasing not only the rate at which plaintiffs file tort suits, but also the settlement amounts in these cases. Contingent-fee arrangements improve settlements for plaintiffs by managing their litigation risk and helping plaintiff-attorney teams to cope better than defendant-attorney teams with the prospect of unreasonably large litigation expenses.

1. Improving Plaintiffs' Bargaining Positions

Most tort plaintiffs, but only a small minority of defendants, pay their lawyers on a contingent-fee basis.[101] It is generally accepted that these contingent-fee arrangements help to correct imbalances in the negotiating positions of plaintiffs and defendants.[102] Indeed, by enabling an individual plaintiff to shift some of the risk of litigation to his or her attorney, a contingent-fee arrangement helps to level the playing field in a lawsuit against an institutional defendant, such as an insurance company, that is willing and able to risk high litigation costs and an adverse judgment in an attempt to obtain a better settlement or verdict. Unlike an individual plaintiff, a plaintiffs' attorney—like a repeat defendant—can spread the risk of losing any particular lawsuit over the numerous suits in his case load.

2. Increasing Settlement Amounts by Decreasing Plaintiffs' Relative Litigation Expenses

Contingent-fee arrangements may increase settlement amounts in an additional way. As noted above, settlements depend not only on the merits, but also upon the relative costs to the defendant and plaintiff of proceeding. Contingent-fee arrangements increase settlement amounts by reducing the resources that plaintiffs devote to litigation.[103]

Plaintiffs themselves do not bear the marginal cost of future litigation—that is, motion practice, discovery, or trial practice. Rather, their lawyers do. But, for now, consider the client and attorney as a unit, and examine the attorney-client team's joint handling of litigation costs.[104] As an empirical matter, hourly defense

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Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working*, 42 MD. L. REV. 215, 231 (1983) (noting that "[a]lthough defendants also may be risk averse, their greater size, financial resources, and ability to insure or seek indemnification creates an imbalance—which predictably tilts the bargaining power in their favor").

101. *See* Trubek et al., *supra* note 5, at 94 (stating the authors' study found that 71% of plaintiffs' attorneys, but only 41% of all attorneys, were paid on a contingent-fee basis); Vargo, *supra* note 76, at 1618 (noting that 97% of personal injury plaintiffs utilize contingent-fee arrangements); Smith, *supra* note 76, at 2162 n.31 (stating that 97% of lawyers accept personal injury cases only on a contingent-fee basis).

102. *See, e.g.*, Gross & Syverud, *supra* note 88, at 349-50.

103. Recall that 97% of personal injury plaintiffs hire their lawyers on a contingent-fee basis. *See* Vargo, *supra* note 76, at 1618.

104. Many have questioned whether contingent-fee arrangements align clients and lawyers' interests better than do hourly-fee arrangements. *See* Terry Thomason, *Are Attorneys Paid What They're Worth? Contingent Fees and the Settlement Process*, 20 J. LEGAL STUD. 187,

attorneys generally spend twice as much time as contingent-fee plaintiffs' attorneys in responding to their opponents' motions.[105] This makes sense, given that plaintiffs' attorneys working under contingent-fee arrangements bear the opportunity cost of any time they spend on a particular case, while defense attorneys are compensated for each hour they work. In effect, contingent-fee arrangements provide lawyers with an incentive to hold down the expense of litigation—which they can do more effectively than clients—and thereby enable plaintiff-attorney teams to handle escalated litigation costs better than defendant-attorney teams.

As a result, such arrangements improve plaintiffs' settlement position by making future litigation less costly for plaintiff-attorney teams than for defendants. Indeed, to the extent that plaintiffs' attorneys can minimize the effects of opponents' tactics to escalate costs (through discovery requests, motion practice, and trial strategy), plaintiffs' attorneys may be in a better position to inflict high litigation costs on the defendant without fear of retaliation.[106] Of course, a large corporate defendant, with abundant resources, may be able to handle such escalatory tactics. It may even be willing and able to escalate legal costs with its own tactics, for example, by attempting to run a solo practitioner ragged. But, from the perspective of deterrence, this defendant will end up devoting significant resources to such cases—perhaps more than if it had settled at the outset.[107] Either way, then, defendants' expected litigation costs lead to higher total payments by defendants.

Given that contingent-fee arrangements may improve a party's bargaining power not only by countering his risk aversion, but also by constraining litigation expense, it is somewhat surprising that more defendants do not pay their attorneys a contingent fee. This additional advantage of contingent-fee arrangements logically should lead defendants to be willing to pay contingent fees, even if such fees include a premium to compensate attorneys for bearing some of the risk of loss.

The relative scarcity of contingent-fee arrangements among defendants may be attributed not only to different risk preferences, but also to practical obstacles. Contingent-fee arrangements for plaintiffs are more straightforward than for defendants. The attorney typically receives one-third of the plaintiff's recovery

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187-90 (1993) (discussing Patricia Munch Danzon, *Contingent Fees for Personal Injury Litigation*, 14 BELL J. ECON. 213 (1983); Kritzer et al., *supra* note 58; Schwartz & Mitchell, *supra* note 40). Conflicts of interest between lawyers and clients that agree to contingent-fee arrangements are addressed below. *See* discussion *infra* Part III.B.3.

105. *See supra* note 58 and accompanying text; *see also* Lawrence C. Marshall et al., *The Use and Impact of Rule 11*, 86 NW. U. L. REV. 943, 964 (1992) ("'most lawyers will prefer to leave no stone unturned, provided, of course, they can charge by the stone'") (quoting Deborah L. Rhode, *Ethical Perspectives on Legal Practice*, 37 STAN. L. REV. 589, 635 (1985)).

106. *See supra* Part II.B (discussing incentive to impose high litigation costs on one's opponent in order to improve one's own settlement prospects).

107. Then again, to the extent that escalation delays any payment by the defendant, the defendant may save the time value of money. *See, e.g.*, Albert Alschuler, *Mediation with a Mugger: The Shortage of Adjudicative Services and the Need for a Two-Tier Trial System in Civil Cases*, 99 HARV. L. REV. 1808, 1823 (1986) (advocating inclusion of prejudgment interest in money judgments).

(often after the attorney's out-of-pocket expenses are deducted), and if a particular client's case is too small for a high profile attorney, that attorney ordinarily will refer the client to an attorney who is willing to earn less, rather than negotiate with the client for a higher percentage of the recovery. Accordingly, lawyers and clients may be matched without having to agree in advance on the case's precise value.

In contrast, contingent-fee arrangements for defendants are substantially more complicated. The defendant and its attorney may agree that the attorney will receive nothing if the plaintiff wins a verdict greater than a certain amount, or a percentage (say one-third) of any savings if the client ultimately pays the plaintiff less than the set amount. Or, perhaps they could agree upon hourly rates that would vary with the measure of success. In any event, unlike the plaintiff, the defendant must agree with his attorney on the case's worth—that is, how success or failure is defined with respect to a case—before it can agree on the terms of a contingent-fee arrangement.

3. Conflicts of Interest Between Attorney and Client

The above discussions—of how contingent-fee arrangements improve plaintiffs' bargaining power and decrease their litigation expenses—treat the attorney and client as a team. However, attorneys and clients who agree to contingent-fee arrangements do not always operate as a unified team. By their nature, contingent-fee arrangements shift the cost of not settling (and proceeding to trial) from the client to his attorney.[108] Contingent-fee arrangements may thus provide the client and the attorney with different incentives.

Putting aside for now the attractiveness of having a sum certain in hand, a plaintiff freed of hourly legal bills has no financial incentive to settle for an amount less than the expected verdict.[109] This is so regardless of how much time and effort it will take to litigate the case.[110] The plaintiff's attorney, by contrast, will be inclined to accept a settlement offer that is lower than the expected verdict because of the saved time and effort (i.e., the opportunity cost).[111] Indeed, because the plaintiff's attorney will receive only one-third of the ultimate verdict but will bear the entire cost of proceeding with the case, he will be inclined to settle for less than a contingent-fee plaintiff, and perhaps even less than a plaintiff paying hourly legal fees. The client paying hourly bills would be willing to accept a settlement that is lower than his expected verdict, so long as his saved legal fees

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108. *See, e.g.*, DOUGLAS ROSENTHAL, LAWYER AND CLIENT 109-12 (1974); Miller, *supra* note 45, at 199; Schwartz & Mitchell, *supra* note 40, at 1126; *see also* Bruce L. Hay, *Contingent Fees and Agency Costs*, 25 J. LEGAL STUD. 503, 513-14 (1996) (focusing on lawyer effort generally, rather than on settlement dynamics).

109. A client's risk aversion, however, might lead him to accept a lower settlement early in a case in order to eliminate the possibility of losing or receiving a low verdict.

110. *See* Miller, *supra* note 45, at 199. This analysis ignores litigation expenses other than the opportunity cost of the lawyer's time, which may, depending upon the nature of the contingent-fee agreement, be paid out of the verdict or settlement before the attorney's one-third share is calculated. *See supra* note 93.

111. *See* Miller, *supra* note 45, at 200-02; Smith, *supra* note 76, at 2173.

exceed the difference; the contingency lawyer would want to accept a difference *three times* as great in order to avoid the costs of proceeding (because he receives only one-third of any gain).

In theory, this difference in incentives could have a dramatic effect on settlement negotiations with defendants. When faced with the choice of whether to settle, a plaintiff's attorney would be inclined to proceed only if additional litigation were likely to increase the settlement (or verdict) by three times the opportunity cost of that additional litigation. A defendant, by contrast, would be inclined to proceed so long as additional litigation would reduce the settlement payment by more than the additional legal bills. Thus, if each hour of plaintiffs' and defendants' attorneys' time were of equal value (and both sides were equally optimistic about the benefits of proceeding), plaintiffs' attorneys would be more eager to settle than defendants. Moreover, this would be true even if plaintiffs' attorneys were able to devote on average half as much time as defendants' attorneys to the same litigation task, as empirical research reveals to be the case.[112] For example, if additional litigation would cost the plaintiff's attorney $100, he would be inclined not to proceed unless he expected his effort to increase the settlement by more than $300. In contrast, assuming the defendant's costs of proceeding were twice as expensive, the defendant would proceed with litigation so long as the additional litigation would reduce the settlement payment by more than $200. Accordingly, the plaintiff's attorney would generally be more willing to settle than the defendant.

In practice, however, this hypothetical choice—between settling or conducting a particular litigation task—is not a real one. First, while contingent-fee plaintiffs' attorneys may spend half as much time as defendants' attorneys on the particular task of responding to opponents' motions, plaintiffs' attorneys tasks may be *qualitatively* different. For instance, the subject matter of many tort suits inherently leads to more extensive discovery requests by plaintiffs, and greater expense to defendants.[113] Moreover, plaintiffs' attorneys may save additional time by postponing tasks; they can reject pending settlement offers as too low and simply let case files sit on their shelves in the expectation of a future offer.[114] Defendants with tight control over case management might benefit from the same strategy; indeed, unless they are later saddled with a verdict that includes prejudgment interest, defendants can earn a return during the delay on any funds they have set aside for the case.[115] But, if the defendants' hourly-fee attorneys do

112. *See* Kritzer et al., *supra* note 58, at 271.

113. *See* Sofaer, *supra* note 67, at 723 (noting that "[d]iscovery is . . . made costly" because "plaintiffs [may] file complaints in which they need do little more than allege an injury that is believed to have resulted from some dangerous instrumentality or activity, and this will generally entitle them to search for an explanation through discovery"); *cf.* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 548-49 (1991) (noting that securities litigation is more expensive for defendants than plaintiffs, in part because discovery is virtually one-sided).

114. *See* Brazil, *supra* note 67, at 226 (discussing delays in discovery scheduling).

115. *See* Alschuler, *supra* note 107, at 1823.

not receive strict instructions to the contrary, they are likely to continue working on the case while it is pending.[116]

In addition, the above comparison between the costs of proceeding to defendants and plaintiffs' attorneys assumed that each lawyer's time was equally valuable. It is unclear, in practice, however, whether the opportunity cost to the plaintiff's attorney of spending an additional hour on a case will have the same value as the actual dollar amount paid by the defendant for the same hour of work. The financial loss to the plaintiff's attorney can equal the hourly fee paid by the defendant only if the plaintiff's attorney has clients waiting to pay a comparable hourly fee, or else an abundance of contingent-fee cases that are just as profitable. Outside the culture of billable hours, it is unclear whether an additional hour worked translates into a concrete expenditure of wealth.

Furthermore, even putting aside these factors, and assuming that plaintiffs' attorneys are more eager to settle than defendants, those attorneys are bound by an ethical obligation to follow their clients' wishes as to settlement.[117] Just as hourly-fee attorneys cannot ethically advise their clients to proceed to trial simply to increase the lawyer's billable time, contingent-fee attorneys cannot ethically advise their clients to settle for an amount that benefits the attorney, but not the client. This is not to say that the attorney's ethical obligation requires him to ignore his own interests completely. Rather, a contingent-fee attorney can serve his clients well simply by considering the collective interests of attorney and client together. As noted above, if the attorney considers the interests of the attorney-client team, the availability of contingent-fee arrangements will increase settlement amounts markedly by improving plaintiffs' bargaining power and decreasing their litigation expenses.

Granted, it is dangerous to rely upon an ethical obligation to overcome financial self-interest.[118] But, as an empirical matter attorneys often *do* proceed

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116. *See* Marshall et al., *supra* note 105, at 963-64 (citing Rhode, *supra* note 105, at 635); Coffee, *supra* note 100, at 247 (noting defense attorneys' incentive to maximize hours).

117. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5 cmt. 3 (1995) ("An agreement may not be made whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the client's interest."); *id.* Rule 1.7 cmt. 6 ("The lawyer's own interests should not be permitted to have an adverse effect on representation of a client."); MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-7 (1980) ("The possibility of an adverse effect upon the exercise of free judgment by a lawyer on behalf of his client during litigation generally makes it undesirable for the lawyer to acquire a proprietary interest in the cause of his client or otherwise to become financially interested in the outcome of the litigation."); *id.* ("[A] lawyer, because he is in a better position to evaluate a cause of action, should enter into a contingent fee arrangement only in those instances where the arrangement will be beneficial to the client."); ROSENTHAL, *supra* note 108, at 110 ("In a few instances, cooling out the client is a breach of legal ethics.").

118. Compare this with Clermont & Currivan, *supra* note 93, who state that:

> [W]e propose that the lawyer and the client are rational, economic beings who tend to act in accordance with their own direct economic best interests. Morality, professional ethics, or even self-interested concern for indirect benefits such as a good reputation might, of course, cause the lawyer or the client to act in a contrary way. Or, one party to the lawyer-client relationship might have sufficient power to force the other to act contrary to the latter's direct economic best interests. For example, an occasional, sophisticated client might be able to control

to trial on their clients' instructions in cases that the attorneys would prefer to settle.[119] Moreover, in these cases business considerations may reinforce ethical obligations, as attorneys seek to maintain a reputation of fulfilling their clients' wishes.[120] In still other cases, plaintiffs' attorneys actually benefit from their clients' desire to hold out for higher settlements.[121] These attorneys may rely on their clients' wishes in settlement negotiations to reject reasonable settlement offers in the hope of receiving still better offers. Thus,

> [c]ontingent-fee contracts give plaintiffs a strategic bargaining advantage. . . . The personal injury plaintiff's attorney can credibly claim that her client will insist on a trial, regardless of the costs, unless she is given some cash in settlement. The defense attorney in most types of personal injury litigation cannot make a parallel claim.[122]

Finally, where the client and attorney fear that they may have deeply conflicting interests, the two can, and often do, agree upon a fee arrangement that provides for a higher fee (e.g., 40% instead of 33%) if the case proceeds to trial.[123] Such

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> the lawyer so that he serves the client's interest more perfectly. Nevertheless, we focus on direct economic interests because our aim is to see how the unrestrained economic animal will act, and then to change the economic environment so that the same animal would be inclined to act in a socially more desirable manner. With such change, society could lessen its reliance on those noneconomic or indirect restraints currently used to bring about socially desirable behavior.

Id. at 534 (footnote omitted).

119. *See* Gross & Syverud, *supra* note 88, at 355 (noting that in a large subset of cases studied, where trials produced recoveries only slightly larger than settlement offers, "the attorneys would predictably have done better to settle, and knew it, but their clients reasonably preferred to go to court"); *see also* Gross & Syverud, *supra* note 100, at 42 (confirming after studying additional trial data that plaintiffs who proceed to trial generally would have done better by settling).

120. *See* Clermont & Currivan, *supra* note 93, at 534.

121. *See* Gross & Syverud, *supra* note 88, at 350-51.

122. *Id.* at 360.

123. *See id.* at 349 n.71; *cf.* ROSENTHAL, *supra* note 108, at 112 (stating that one "option for resolving the conflict between the lawyer's and client's interests is to bring the specific conflict issues up for discussion"); Bruce L. Hay, *Optimal Contingent Fees in a World of Settlement*, 26 J. LEGAL STUD. 259 (1997) (advocating a fee structure in which attorneys receive a larger portion of a recovery in the event of a trial). In theory, rather than simply using the pretrial conference as a dividing line, the fee arrangement could be scaled to reflect the attorney's added effort throughout the course of the litigation. In practice, however, it might be difficult both to agree upon these terms in advance, and to monitor when the attorney has exceeded a certain level of effort and therefore is entitled to a higher fee. Such an arrangement might result in the same costly ex ante and ex post negotiations over fees in which hourly attorneys and their clients often engage. In addition,

> even if a graduated fee scale were so precise as to give the attorney the same return from settlement at any point in the lawsuit, there is no guarantee that the settlement figure that the attorney would accept would give the client a return equal to the client's return from trial.

Miller, *supra* note 45, at 201-02.

arrangements encourage the attorney to proceed to trial, instead of convincing his client to accept a low settlement.

4. Summary

The availability of contingent-fee arrangements thus not only increases the rate at which plaintiffs file lawsuits, but also increases settlement amounts by improving the bargaining power of plaintiffs and enabling them to handle unreasonably high litigation costs better than defendants. True, some lawsuits may result in settlements that are no higher, or perhaps lower, than would result if plaintiffs could afford to hire hourly attorneys, because some contingent-fee attorneys may convince some clients to settle based on the attorney's, rather than the client's, or their collective, interests. But, given that many plaintiffs can sue *only* because of contingent-fee arrangements, and that the remaining plaintiffs who would have sued anyway (even if contingent fees were not permitted) are still free to hire hourly attorneys, a rule that allows contingent fees substantially benefits plaintiffs and increases the amount that potential defendants pay for lawsuits. Moreover, because sliding-scale fee arrangements help alleviate conflicts of interest between attorney and client, and because the plaintiffs' interests often prevail where conflicts do arise, contingent-fee arrangements, on balance, ensure that the negotiating positions of plaintiffs are comparable to those of defendants.

In short, the availability of contingent-fee arrangements prevents potential defendants from expecting to capture the lion's share of bargaining surplus in each case and, consequently, from expecting to pay settlements that do not cover the value of their victims' injuries. By ensuring that defendants generally expect to pay fair settlements for meritorious tort claims, contingent-fee arrangements protect against underdeterrence.[124]

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124. Thus, while Polinsky and Rubenfeld hypothesize that settlements may result in underdeterrence because plaintiffs forego some meritorious claims and defendants pay less than their victims' injuries, for others these assumptions do not hold true. *See supra* note 84. Gross and Syverud offer another reason why defendants may be willing to pay more than plaintiffs ask in settlement negotiations. *See* Gross & Syverud, *supra* note 100, at 37-38. Because a large portion of total tort awards is awarded in a handful of cases, while half of tried cases result in zero recoveries for the plaintiff, the difference between mean and median jury awards can be quite large. *See id.* "For a plaintiff," they explain, "a mean so heavily influenced by rare large verdicts is an inflated estimate of the value of a claim." *Id.* at 37. Yet, for a repeat defendant, "the mean expected judgment is an excellent estimate of the cost of a case." *Id.* at 38. Accordingly,

> [i]f the risk . . . to the [repeat] defendant is measured by the mean judgment for similar cases, but the value to the [one-shot] plaintiff is much lower—in the range between the median and the median of nonzero awards—then there is a large range of possible settlements between what the plaintiff expects to get and what the defendant fears losing.

Id.

C. Defendants' Presettlement Litigation Expenses

In addition to paying settlements to plaintiffs, however, defendants must pay presettlement legal fees. As background, recall that if two parties were to agree on a case's factual and legal merits before engaging in discovery or motion practice, they could avoid much of litigation's cost simply by settling the case for its agreed-upon value.[125] Recall, also, that if such scenarios were common in practice, the filing and settlement of meritorious lawsuits would provide defendants with efficient deterrence incentives. It would not matter that our rules governing discovery and fee shifting result in unreasonably high litigation costs, beyond one's own control, that must be borne regardless of the merits. Defendants would expect to avoid these litigation costs simply by settling early, and thus expect to pay amounts for the injuries they inflict that are closely tied to the merits.

It was also demonstrated earlier, however, that plaintiffs and defendants cannot avoid the high costs of litigation simply by settling.[126] At the outset of a case—before the parties have undertaken discovery or filed any motions—the parties are likely to disagree about the value of a case. Parties are likely to handle their disagreement over the merits either (1) by engaging in some discovery and motion practice *before* settling, or (2) by settling for an amount that does not accurately reflect the merits of a case, but rather depends upon the parties' relative litigation costs and bargaining strengths.[127]

Consider the latter category of cases first—that is, cases in which parties negotiate settlements, before any discovery or motion practice, based as much upon the parties' relative litigation costs and bargaining strengths as upon their views of the merits. A large portion of these cases may be weak or meritless. Another portion may be strong cases that are settled for much less than their merits warrant. In any given case, then, the resulting random settlement amount is likely to be too high or too low.

On average, however, these errors might offset one another and defendants might ultimately pay amounts that reflect the suits' aggregate merits. Indeed, this is likely given that tort defendants generally approach litigation with superior bargaining power, but contingent-fee arrangements alleviate the disparity by managing plaintiffs' litigation risk and enabling plaintiff-attorney teams to handle escalated litigation costs better than defendants.[128] Under such conditions, early settlements are likely, on average, to be accurate, as plaintiffs would settle meritorious cases for too little just as often as defendants would settle weak, or meritless, cases for too much. The resulting problem with deterrence would *not* be that defendants would consistently expect to pay too much or too little for lawsuits, but rather that they would pay amounts bearing little relation to the merits. Indeed, a defendant might prefer such random, but on average equitable,

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125. *See supra* Part II.B.
126. *See supra* Part II.B.
127. *See supra* Part II.B.
128. *See supra* Part III.B.

settlements over paying fair settlement amounts *plus* litigation expenses. If so, the defendant might seek to settle every case early in order to avoid paying consistently too much.

In reality, however, a defendant could not hope to lower its tort-related payments with this strategy, for as soon as plaintiffs' attorneys were to learn of the defendant's willingness to settle early, the strategy would lead to an increase in weak and meritless filings.[129] The defendant might save litigation expenses in some cases, but it would end up paying more to settle weak and meritless cases than if it had decided to engage in some discovery and motion practice. Thus, although there may be a subset of cases in which defendants and plaintiffs agree to settle early, despite wide disagreement, in order to avoid the costs of discovery and motion practice, defendants cannot ensure this outcome in any particular case, let alone in most cases. A defendant may reduce its presettlement litigation expense by settling early *or* it may reduce the settlements it pays for meritless cases by refusing to settle, but it generally cannot do both.

Now return to the first category of cases, those in which the parties settle *after* engaging in some discovery. In these cases, defendants will pay *both* presettlement discovery expenses (to their attorneys) *and* settlements (to plaintiffs). Moreover, as Part II demonstrated, because the rules governing discovery and motion practice provide neither proper incentives nor external control over the parties' tactics, the defendant's presettlement litigation expenditures are likely to be unreasonably high.[130] Indeed, the costs incurred prior to settlement—in pleadings, discovery and motion practice, as well as in negotiations—will often exceed the costs of trial preparation and trial that would be incurred if the parties failed to settle.[131] Thus, to the extent that parties wait to settle until the eve of trial, they will already have borne the bulk of possible litigation expenses.[132]

In short, when contingent-fee arrangements are considered together with liberal discovery rules and a refusal to shift fees, it becomes clear that defendants generally cannot expect to dispose of meritorious tort claims without paying both fair settlements to plaintiffs and significant presettlement fees to their lawyers.

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129. *Cf.* Robert G. Bone, *Modeling Frivolous Suits*, 145 U. PA. L. REV. 519, 552 (1997) ("Defendants want plaintiffs to know the truth when their suit is meritless, but not when their suit is meritorious.").

130. *See supra* Part II.B. Of course, included within these costs are the costs of settlement negotiations themselves—that is, the time it takes defense lawyers to negotiate settlements. *See* Galanter, *supra*, note 1, at 28.

131. *See* Trubek et al., *supra* note 5, at 90, 104 (noting that trial on average will add less than 10% to the time an attorney devotes to a case); *supra* note 71. *But cf.* Gross & Syverud, *supra* note 100, at 33 (noting that the average personal injury trial lasts eight days).

132. To the extent that litigation is not only expensive, but also prolonged, defendants' legal fees may be offset partially by the time value of money. *See, e.g.*, Alschuler, *supra* note 107, at 1823.

D. Contingent-Fee Arrangements and Meritless Lawsuits

Defendants also must incur some expense to dispose of meritless lawsuits. Indeed, the United States' decision to allow contingent-fee arrangements but not fee shifting tends to increase the number of meritless, as well as meritorious, filings. Recall that plaintiffs have an incentive to file lawsuits whenever an attorney is willing to represent them for a contingent fee. Moreover, as noted earlier with respect to small meritorious lawsuits, a plaintiffs' attorney may hope to profit from a case, even if the expected verdict will not cover his total litigation expenses, so long as he can induce the defendant to settle before trial for an amount that will cover three times the attorney's effort up to that point.

One might expect that where a case is meritless, and the anticipated recovery is zero (or close to zero), the plaintiff's attorney will have difficulty presenting a credible threat of continued litigation at each stage. Simply consider the attorney's position on the eve of trial if no settlement has been reached: with an expected recovery of zero, the attorney would be inclined to drop the case no matter how little it would cost to try it.

Nevertheless, there are several explanations for why plaintiffs' attorneys may hope to profit from meritless lawsuits.[133] Some of these explanations would apply as well to plaintiffs who pay hourly fees. On balance, however, contingent-fee arrangements (together with non-fee-shifting) tend to increase meritless filings.

1. Information Asymmetries

First, a plaintiffs' attorney may credibly threaten to litigate a meritless lawsuit where information asymmetries are present.[134] A plaintiffs' attorney may hope to settle a case that he knows to be meritless if he, alone, has seen its flaws and if he hopes that discovery will fail to reveal its weaknesses before the defendant agrees

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133. Avery Katz's and Lucian Bebchuk's models help to explain plaintiffs' incentives to file and defendants' incentives to settle suits that only plaintiffs know to be meritless. *See* Bebchuck, *supra* note 94, at 439 (noting that the success of "negative-economic value" suits may be explained "by defendant uncertainty as to whether or not the suit is an NEV one"); Avery Katz, *The Effect of Frivolous Lawsuits on the Settlement of Litigation*, 10 INT'L REV. L. & ECON. 3, 4 (1990) ("The main reason that frivolous suits are not always met with a blanket denial and refusal to negotiate, of course, is that the defendant rarely knows the merits of the claim with certainty."). Robert Bone has discussed Katz's model of "informed-plaintiff" information asymmetries and has modeled as well asymmetries in which defendants are aware of a suit's flaws but plaintiffs are uninformed. *See* Bone, *supra* note 129, at 524 ("Frivolous litigation is most likely to occur under conditions of asymmetric information."). David Rosenberg and Steven Shavell have modeled "nuisance value" suits that both parties view to be meritless, but which may nonetheless profit plaintiffs because the timing and extent of litigation effort favors them. *See* David Rosenberg & Steven Shavell, *A Model in Which Suits are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3 (1985).

134. *See* Bebchuk, *supra* note 94, at 439; Katz, *supra* note 133, at 4.

to settle.[135] This risk-laden strategy, which requires a basic understanding of discovery practices (and an ability to predict the point in the litigation process when the defendant is likely to learn a relevant fact), is less likely to work for plaintiffs who pay their attorneys an hourly fee than for plaintiffs and attorneys who agree to a contingent-fee arrangement. Plaintiffs' attorneys are better able than their clients to predict, and to exploit, their opponents' mistakes.

A different sort of information asymmetry—in which the plaintiff rather than the defendant is mistaken—may enable plaintiffs credibly to threaten continued litigation, whether they pay hourly or contingent fees.[136] For example, a plaintiff and his attorney might choose to file, and litigate, an ultimately meritless lawsuit if they believe that the case has merit or that discovery will reveal previously unknown strengths. Even if the defendant knows he ultimately would win at trial, he nevertheless may be willing to settle early in order to avoid the costs of litigation—that is, the cost of educating his opponent or the court about the true nature of the case. Alternatively (and perhaps more likely), the informed defendant will defend these meritless claims and incur significant expenses in the process.[137]

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135. *See* Brazil, *supra* note 67, at 225 (noting that because discovery is so expensive, attorneys often advise clients to forego discovery and settle, even where they suspect that opponents may be hiding information). If defendants fear that settling when they are uninformed will invite more meritless suits and ultimately cost them more than their saved litigation costs, then defendants will refuse to settle and meritless filings will cause harm *not* by transferring wealth unjustly from defendants to plaintiffs, but rather principally because of the extra litigation costs defendants will incur to defend both meritorious and meritless cases. *See* Bebchuck, *supra* note 94, at 441; Bone, *supra* note 129, at 549. Only if defendants consistently refused to settle where they are uninformed would plaintiffs be discouraged from knowingly filing meritless cases in the first place. However, Katz has demonstrated that the greater the defendants' litigation costs, the more likely it is that plaintiffs will file meritless suits (because defendants will be willing to settle a greater percentage of them). *See* Katz, *supra* note 133, at 14. The unreasonably high costs of litigation outlined in Part II, and plaintiffs' power to inflict litigation costs on defendants through discovery, thus support the intuition that plaintiffs sometimes knowingly file and profit from meritless cases.

136. Indeed, the scholarship cited in the preceding and succeeding footnotes discusses the relevant issues from the perspective of plaintiffs who pay hourly fees, rather than that of plaintiffs' attorneys deciding whether to work for a contingent fee.

137. Robert Bone analyzes an uninformed plaintiff's decision either to investigate a claim before filing or else to file a potentially meritless claim and bear the risk of litigating a case that might lose. *See* Bone, *supra* note 129, at 559-63. He identifies three different equilibria: (1) an "investigation equilibrium" in which plaintiffs always investigate because investigation costs are low relative to discovery costs; (2) a "filing equilibrium" in which plaintiffs always file without investigating because investigation costs are high relative to discovery costs; or (3) a "mixed equilibrium" in which plaintiffs investigate sometimes and file sometimes, based on more closely aligned investigation and discovery costs. *See id.* Under the filing and mixed equilibria, Bone explains, defendants incur greater litigation costs than they would if plaintiffs were to investigate before filing, because defendants have to incur expense defending some meritless cases (although under the mixed equilibrium defendants may recoup some of that expense by inducing uninformed plaintiffs to drop some meritorious cases). *See id.* Because of the discovery and non-fee-shifting rules outlined in Part II, cases at the "investigation equilibrium" may be much fewer than Bone envisions and cases at the socially costly "filing equilibrium" much more numerous. Bone fails to take into account that even where prefiling

In theory, plaintiffs' attorneys who work for contingent fees should be warier of misjudging a case's worth than hourly attorneys, as contingency attorneys bear the opportunity cost of litigating losing cases.[138] In contrast, clients who pay hourly fees should have greater incentives to avoid mistakes than contingency clients, for hourly-fee arrangements require the client to bear the costs of unsuccessful litigation. Because attorneys should be better able than their clients to judge the value of a case, and contingent-fee arrangements give the attorney, rather than client, an incentive to avoid inaccurate predictions of the verdict, one would expect fewer meritless filings under contingent-fee arrangements.

In practice, however, most contingent-fee plaintiffs' attorneys earn their living by filing more suits than they have time to investigate.[139] Ultimately, contingent-fee arrangements may lead to less thorough prefiling investigation than an hourly-fee structure.

2. Timing and Extent of Litigation Effort

Indeed, a contingent-fee structure may induce plaintiffs to file even those suits that *both* sides consider weak or meritless from the outset. As noted above, contingent-fee plaintiffs' attorneys file many cheap, "cookie-cutter" complaints that take little time to prepare, thus placing the onus upon the defendant either to settle the case quickly or else to pay a lawyer to prepare an answer (and/or a motion to dismiss) that reveals the claim's flaws.[140] Even if a defendant expects that the plaintiff eventually will drop the case (or allow it to linger on the docket without further action), the defendant nonetheless may offer a nuisance settlement in some cases to avoid the costs of responding.[141] The key to success for the plaintiffs' attorney in these meritless cases is ensuring that the defendant is the first party to face significant costs—so that the defendant will have an incentive to settle even if he knows the plaintiff later will drop the case, and so that the plaintiff can indeed drop the case with only minor losses if the defendant refuses to settle.[142] Another crucial point is that the plaintiffs' attorney must avoid

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investigation costs are quite small (and plaintiffs expect defendants to refuse to settle meritless claims), plaintiffs might still file claims without any investigation in order to shift investigation costs (via discovery) to defendants. In a system of litigation in which the opponent bears the costs of investigation once a complaint is filed, it may be cheaper for plaintiffs to file than to investigate. *See* Alexander, *supra* note 113, at 548-49 (discussing plaintiffs' ability to take advantage of one-sided discovery); Sofaer, *supra* note 67, at 723 (same).

138. See Clermont & Currivan, *supra* note 93, at 571-72; Rowe, *Predicting the Effects*, *supra* note 76, at 152.

139. *See* Brazil, *supra* note 67, at 226.

140. Plaintiffs who pay their attorneys an hourly fee have neither the close control over their own expenditures, nor the multitude of available lawsuits, to make this strategy profitable.

141. Rosenberg and Shavell's article provides an economic analysis of why plaintiffs may file suits that both sides know to be meritless from the outset. *See* Rosenberg & Shavell, *supra* note 133, at 3.

142. In his attempt to avoid devoting too many resources to these cases at the outset, the plaintiffs' attorney would have to be careful not to file suits that are so patently frivolous as to invite sanctions under Federal Rule of Civil Procedure 11 or the state law equivalent. *See* FED. R. CIV. P. 11; *cf. infra* Part V (discussing modifications of the Rule 11 standard that could

targeting the same defendant too often: as noted earlier, defendants will fear inviting more suits if they develop a reputation for paying nuisance settlements.[143]

A weak or meritless case may also be profitable for a plaintiffs' attorney even if the initial complaint takes some time to prepare, so long as he is confident that future litigation will hurt the defendant more than it will hurt the plaintiffs' attorney. Empirical research suggests that a strategy of inflicting costs to induce settlement may be feasible for contingent-fee plaintiffs' attorneys, because, as noted above, they spend, on average, only half as much time responding to their opponents' motions as hourly defense attorneys do.[144] Moreover, certain types of cases may lend themselves to lopsided discovery, enabling the plaintiff to inflict even larger costs on the defendant.[145] Although large corporate defendants might seem better equipped to bear expensive litigation than small firms of plaintiffs' attorneys (and clearly are better equipped than individual plaintiffs who pay hourly fees), these defendants nonetheless may be induced to settle either because they retain less control over their own litigation expenses than do contingent-fee plaintiffs' attorneys, or because they wish to avoid disproportional discovery.

3. The Client's Wishes

There is one additional—and important—reason why the availability of contingent-fee arrangements may increase the amounts that defendants are induced to pay in order to dispose of meritless cases. Consider a meritless lawsuit in which a plaintiffs' attorney has pursued one of the strategies described above: he hoped at the outset that the defendant would settle before learning of the case's weaknesses, that discovery would reveal strengths, that the defendant would settle before the plaintiffs' attorney devoted any resources, or that the defendant would settle simply to avoid expensive litigation. Further imagine that the strategy has failed. The defendant has refused to settle and both attorneys now agree that the plaintiff will lose if they go to trial.

The plaintiffs' attorney working for a contingent fee nonetheless may credibly threaten continued litigation if his client wishes to continue. Unlike the plaintiff who pays an hourly fee, a contingent-fee attorney may not be able to drop a case simply because it has become unprofitable. If the attorney cannot convince his client to drop the case, he is obligated to continue—even if it means losing money (or bearing the opportunity cost of proceeding).[146]

To summarize, when the availability of contingent-fee arrangements is considered together with discovery and non-fee-shifting rules, the total amount that defendants pay to defend and settle lawsuits generally exceeds what they would pay under substantive law alone. This is true because defendants' total tort payments cover not only their victims' injuries (as substantive law would

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discourage meritless filings).

143. *See supra* Part III.C.

144. *See* Kritzer et al., *supra* note 58, at 271; *supra* Part III.B.2.

145. *See* Alexander, *supra* note 113, at 548-49; Sofaer, *supra* note 67, at 723.

146. *See* Gross & Syverud, *supra* note 88, at 350-51 (noting that obligation may stem from ethics rules or simply from a wish to preserve the attorney's reputation among potential clients).

require), but also the unreasonably high costs of litigation outlined in Part II and the significant costs of defending and/or settling meritless cases as well.

IV. SKEWED DETERRENCE AND COMPENSATION

The tort theory discussed in Part I assumes that people (both corporations and individuals) structure their behavior to minimize their potential liability under the governing substantive law.[147] Under a negligence regime, they take only reasonable risks, so that they will not be held liable for any resulting injuries. Under a strict liability regime, they structure their activities so as to ensure that anticipated profits exceed anticipated damages from any resulting injuries. According to both negligence and strict liability advocates, then, tort law's deterrent effect results from potential liability under the relevant substantive law.

Parts II and III demonstrated, however, that in practice defendants ordinarily do not pay for the injuries they inflict simply according to relevant substantive law. Rather, plaintiffs decide to sue, and parties reach settlements, based upon the anticipated expense of litigation as well as upon the merits of the given case. A company that wishes to pursue a business endeavor, then, will consider not simply the likelihood that the endeavor will cause injury for which it will be liable, but also the ancillary costs of litigation. While these two considerations are related, the discussion thus far has demonstrated that they are not identical. Parts II and III explored how procedural rules—regarding discovery, fee shifting, and contingent-fee arrangements—can alter the amount that potential defendants expect to pay for their conduct. Those Parts explained that these procedural rules, when combined, aggravate the divergence between the merits of cases and the amounts defendants expect to pay for them, leading defendants to expect to pay more than the merits warrant for meritorious cases and significant amounts even for meritless cases. The discussion that follows addresses the resulting impact of these procedural rules on tort law's dual goals of deterrence and compensation.

A. Predictability and Deterrence

The extent to which procedural rules skew a substantive rule's deterrent effect depends upon whether they influence litigation and settlement dynamics in a predictable manner. Deterrence, after all, is achieved only to the extent that actors can anticipate ex ante the legal consequences of their actions.[148] A procedural rule thus can affect tort law deterrence only if it applies with predictability and leads to a foreseeable result.[149]

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147. *See supra* Part I.

148. *See* Kaplow, *supra* note 33, at 309 (noting that "greater accuracy [in adjudication] is valuable only to the extent it involves dimensions about which individuals are informed at the time they act").

149. Of course an actor may alter his actions based upon the fear that a certain rule will apply even if he does not know for sure that it will apply. The text does not equate foreseeability with certainty. For an in-depth analysis of the effects of uncertainty on deterrence incentives, see generally Calfee & Craswell, *supra* note 4. *See also* Grady, *supra* note 33, at 806 (criticizing conventional negligence theory's "assumption that injurers can always identify

Each of the rules described above as affecting litigation costs is applied almost uniformly throughout the United States. Accordingly, individuals and companies doing business in the United States know that if they are sued for conduct here, the resulting lawsuits will be litigated in a system that allows liberal discovery and contingent fees, but does not shift legal fees from the winner to the loser.[150] Moreover, the general effect of these rules on litigation expenses and settlement values is sufficiently predictable to influence deterrence. As discussed in Parts II and III, the rules regarding discovery, fee shifting, and contingent-fee arrangements lead potential defendants to expect to pay not only for the injuries of tort victims—as substantive law would require—but also for presettlement litigation expenses in meritorious cases, as well as the significant amounts needed to dispose of meritless claims.

The following sections explore how the prospect of paying anything for meritless cases and paying high ancillary costs for meritorious cases leads to overdeterrence in both negligence and strict liability regimes.

B. Settlement Without Regard to Causation

Corporations and individuals may, *in theory*, pursue a course of conduct without fear of liability so long as they are confident that their actions will not actually cause an injury, because neither a negligence regime nor a strict liability regime will impose liability absent proof of causation. *In practice*, however, the dynamics of litigation and settlement described above may lead a corporation to expect to incur some expense even for injuries that it does not cause.

Consider a drug manufacturer that wishes to market a new form of oral contraceptive. If it discovers side effects, then the company will choose not to market the drug if its exposure to liability exceeds its anticipated profits.[151] No matter how thorough its tests, however, the company faces the possibility that some of its customers will suffer medical ailments that they believe to be caused by the contraceptive.[152] If some of these customers find attorneys willing to take their cases for a contingent fee, then the costs of litigation will lead the company

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with perfect certainty the precaution level that courts will determine to be" reasonable). For a discussion of the effects of uncertainty on a plaintiff's decision to sue, see Bebchuk & Chang, *supra* note 76, at 373 (discussing effects of different fee-shifting regimes where the "outcome of trial is unlikely to be certain to the plaintiff when it decides whether to sue").

150. Alaska, however, has a modified version of the English fee-shifting rule. *See* ALASKA R. CIV. P. 82 (setting forth schedule of fees that may be awarded to a successful plaintiff, but leaving judge to decide on fees to be awarded to a successful defendant).

151. Or it may obey the law for other reasons, such as a sense of doing the right thing or avoiding damage to its reputation.

152. *See* STEPHEN G. BREYER, BREAKING THE VICIOUS CIRCLE 16, 33 (1993) (noting the difficulty we have with managing very small risks and the psychological desire to assign blame to a definite cause). Unfortunately, not only these potential plaintiffs, but also juries, judges, and society generally, may have difficulty weighing scientific evidence to determine what actually caused these ailments.

to expect to pay out settlements, or at least incur litigation expense, for lawsuits based on injuries that are unrelated to its product.[153]

It is both inefficient and unfair to require defendants to bear any expense for injuries they do not cause. True, the economic and moral justifications for strict liability sensibly impose liability on the assumption that the defendant, rather than the courts, is in the best position to determine whether there were reasonable precautions that could have prevented an injury.[154] Moreover, the company that tested, refined, and manufactured the product may also be in the best position to determine as well whether *any* precautions—reasonable or unreasonable—could have avoided the accident. But this does not mean that the producer should be liable where proof of causation is absent.

The arguments in favor of strict liability do not apply where causation, rather than fault, is in doubt. The economic and moral justifications for strict liability all rest upon the premise that an activity's true costs should be internalized. If the beneficiaries of an activity bear all of its actual costs, then they will (1) take reasonable safety precautions, (2) weigh accident costs in deciding among alternative activities, (3) effectively insure themselves against the costs of mishaps by spreading those costs, and therefore (4) share in the moral responsibility and accountability for the injuries to which they contribute.[155] In contrast, imposing liability where causation is in doubt might force an activity to bear *external* costs—that is, the costs of unrelated accidents. Imposing liability for such external costs actually *undermines* the economic and moral justifications for liability.

Most obviously, these external costs tend to overdeter reasonable activity by favoring potentially less efficient alternative activities. If tort liability drives up the price of a product, for example, consumers will be inclined to purchase substitutes. The imposition of external costs may also encourage excessive, inefficient safety precautions. Although actors cannot, by definition, do anything to prevent injuries that are not caused by their conduct, they might nevertheless be encouraged to adopt extra measures *that appear* to be safety related so as to bolster a causation defense (if they anticipate having to prove that their conduct could not possibly have caused a particular injury.)[156]

Moreover, settlements paid without regard to causation impose mandatory social insurance where it may be unnecessary and inefficient. Unlike traditional insurance, which spreads the costs of accidents according to broad categories of risks (based on age and medical history, for example) the mandatory insurance scheme imposed by strict liability has a very precise risk pool. Instead of all those

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153. In addition, the company will take into account that other drug makers have been held liable for medical ailments where the evidence of causation was quite weak. *See* PETER W. HUBER, GALILEO'S REVENGE: JUNK SCIENCE IN THE COURTROOM 1-2 (1991) (noting instances in which legal causation has been found despite strong scientific evidence to the contrary).

154. *See supra* Part I.B.

155. *See supra* Part I.B.

156. Even if a company cannot disprove causation simply by pointing to its safety precautions, its ability to point to these precautions may nevertheless improve its posture before a jury and lessen the verdict against it, for example, by eliminating punitive damages. *See* Calfee & Craswell, *supra* note 4, at 987.

who hold medical insurance sharing the cost of an injury caused by a certain drug, only those who use the drug will pay their share of the injuries it inflicts.[157] Strict liability achieves economic efficiency by spreading the costs of an accident over a more pertinent category of people than general insurance. But where causation is in doubt, tort law's cost spreading does not add anything to general insurance, which already spreads accident costs over a broad category of risk takers.[158]

The moral arguments for imposing liability also break down where causation is in doubt. Recall that the moral justification for imposing liability only upon those who are negligent is that a person's decision to inflict a risk upon others that he would accept for himself—that is, a reasonable risk—is not deemed blameworthy.[159] Recall also the opposing moral argument (for strict liability): rather than leave the costs of reasonable risks wherever they fall, it is more equitable to shift them to the beneficiaries of those risks.[160] Without proof of causation, however, the moral argument for liability collapses. Perhaps society generally should help out the unfortunate few who suffer inexplicable injury, but it is arbitrary and unfair to blame a limited number of actors whose connection to the injury is tenuous, and likely nonexistent.[161]

C. Settlement Without Regard to Negligence

In a negligence regime, individuals are free, in theory, to act without fear of tort liability so long as they take reasonable safety precautions. Take, for example, a businessperson who wishes to open a minor league baseball stadium in his hometown. If he is worried that spectators may be hit by foul balls, he can avoid liability under a negligence rule by adopting reasonable safety precautions (e.g., a net behind home plate), which he may select based upon the rate of such accidents in other stadiums and the effectiveness of precautions in those stadiums. In theory, these reasonable precautions—that is, whose benefits outweigh their burdens—would suffice to shield him from liability.[162] Or consider a construction company that contracts to repave sidewalks outside of office buildings, and is

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157. *See* CALABRESI, *supra* note 6, at 50-54 (distinguishing two arguments in favor of enterprise liability: (1) "plac[ing] losses on those categories of people who are most likely to insure," and (2) "placing losses on those who are in a position to pass part of the loss on to purchasers of their products or to factors employed in the production of their products").

158. Tort law does, however, provide more extensive compensation than private insurance. If someone wanted more complete coverage, he or she could, in theory, purchase an insurance policy that would cover such items as pain and suffering. However, such an option is not typically available in practice. On the other shortcomings of private insurance as compared to tort liability, see *id.* at 55-64.

159. *See supra* Part I.A.

160. *See supra* Part I.B.

161. When we are confronted with a calamity, our desire to understand the cause is strong. *See* BREYER, *supra* note 152, at 16, 33. Nevertheless, it is unfair to lay blame prematurely, without sufficient evidence, simply in order to satisfy this psychological need for definite answers.

162. *See generally* KEETON ET AL., *supra* note 7, § 62, at 432-33 (noting that a general negligence standard has replaced the traditional varying degrees of care owed to entrants upon land).

therefore afraid of "slip and fall" lawsuits by passing pedestrians. In theory, this company too could avoid liability in a negligence regime, so long as it took reasonable precautions—say, insuring that wet pavement areas were roped off, that the areas were well marked, and that construction tools were locked away each evening.

But, in reality, neither the businessperson nor the construction company could reasonably expect to escape all litigation expense simply by complying with a negligence standard. If each believes that someone will likely be injured at the ball park or construction site, each also reasonably will expect to incur some expense in defending and/or settling lawsuits, regardless of whether it is legally at fault.[163]

Thus, despite a substantive tort law regime that imposes liability only upon proof of negligence, the potential defendants' analysis would resemble that appropriate for a strict liability regime. They would not expect to avoid all litigation costs simply by taking reasonable safety precautions. Rather, they would expect to pay something for accidents—in the form of legal fees and/or settlements—even where they have taken reasonable precautions.[164]

Of course, substantive legal rules would affect the businesses' anticipated accident-related expenses, and hence would affect deterrence. If they take reasonable safety precautions, then they might expect to pay less to settle cases in a negligence regime (where they would be more likely to win at trial) than in a strict liability regime.[165] But, importantly, the substantive legal rule is only one of the factors that the construction company, for example, would consider in calculating the accident-cost component of its construction bids. Even in a negligence regime, it would anticipate bearing some expense without regard to fault.

Expecting to pay for nonnegligent conduct is not quite so grave as expecting to pay for conduct without regard to causation. In some areas of tort law, after all, our society *chooses* to impose liability without regard to fault. Moreover, just like a negligence regime, a strict liability regime seeks to deter unreasonable risks (albeit by requiring the defendant to pay for all accidents and to sort out for himself which precautions are reasonable).[166] Thus, the imposition of liability for nonnegligent conduct should not alter a potential defendant's incentive to adopt reasonable safety precautions.

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163. Indeed, the construction company would factor anticipated litigation and settlement costs (if it self-insures) or the liability insurance premiums that cover these costs (if it purchases insurance) into its construction bids.

164. True, if defendants have difficulty distinguishing between meritless and meritorious cases, this might lead defendants not only to offer too much for meritless cases, but also to offer less for meritorious cases than it otherwise would—that is, to reduce settlement offers in those cases where they truly were negligent. *See* Bebchuk, *supra* note 93, at 441. However, this would not decrease the total amount that defendants ultimately have to pay, but rather would simply increase the rate at which meritorious cases go to trial. *See id.*

165. *See* Viscusi, *supra* note 91, at 327-28.

166. *See supra* Part I.C (noting the similarities between negligence and strict liability regimes).

Nonetheless, a procedural system that imposes costs for reasonable conduct despite a governing negligence standard is inefficient in two respects. First, although such a regime may transform a negligence rule into a strict liability rule, it fails to achieve one of the principal economic benefits of strict liability: tertiary cost savings. In a strict liability regime, defendants (and plaintiffs and courts) save the cost of litigating negligence. That cost is present, however, in a regime that purports to apply a negligence standard, but in practice requires defendants to pay some amount for nonnegligent conduct. The funds that defendants devote to litigating fault in a negligence regime could serve the higher purpose in a strict liability regime of compensating plaintiffs for their injuries.[167]

Second, where the procedural regime transforms a negligence rule into a rule of strict liability, the procedural regime will internalize accident costs where such internalization may not be desirable. Recall that strict liability promotes safety not only by encouraging reasonable safety precautions—a goal shared by negligence and strict liability regimes—but also by internalizing the accident costs of even nonnegligent conduct. Strict liability thereby encourages actors to allocate resources to less risky endeavors. Indeed, the imposition of only negligence liability for certain activities has been criticized because it tends to insulate those activities from their true accident costs and thereby to favor them over less risky alternatives.[168] Yet, society may decide to impose a negligence standard precisely because it *wants* to subsidize a particular industry whose public benefits exceed the profits its proprietors can hope to earn. Even if other investments with comparable profits would entail lower accident costs, society might choose to encourage investment in a particular industry by imposing only negligence liability and allowing general medical insurance to bear remaining accident costs. Such a goal cannot be achieved, however, in our procedural system. By requiring the industry to bear accident costs even for nonnegligent conduct, a procedural regime that transformed a negligence rule into one based on strict liability would undermine the policy choice that underlies our substantive law rule.

On balance, the first of these two problems—the cost of litigating fault—is probably the more serious, as it is present in virtually every case. The second problem—that of undermining society's decision to subsidize business—would be present only in those instances where the substantive law negligence rule is actually motivated by a desire to subsidize business. If society were indifferent as between internalizing an industry's accident costs or allowing general medical insurance to pay, then there would be less harm in having the procedural system override substantive law and internalize the accident costs of nonnegligent conduct.

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167. Nor will a repeat defendant avoid the extra cost of litigating fault simply by ignoring the negligence standard and paying settlements as if it were operating in a strict liability regime. As discussed earlier, a defendant who adopts such a strategy of settling without regard to the merits would invite plaintiffs to file more weak and meritless cases. *See supra* Part III.C.

168. *See* HORWITZ, *supra* note 27, at 97-101 (explaining how a negligence standard historically has subsidized "those who undertook schemes of economic development").

D. Tertiary Costs Become Primary and Secondary Costs

The discussion thus far has pointed out the problems that occur when an actor expects to pay for conduct regardless of the substantive law requirements of causation and negligence. The former problem of payment without causation is the more obviously serious: if people fear having to pay for conduct that mistakenly may be believed to cause injuries, then they will be deterred from engaging in that conduct and will tend to avoid it even if it is, on balance, beneficial to society. The resulting overdeterrence is the strongest justification for civil law reform. The latter problem, of procedural rules overriding a substantive law negligence rule, is largely a matter of additional transaction costs associated with litigating fault.

Ultimately, however, these transaction costs, and the costs of litigating even *meritorious* cases, in *both* negligence *and* strict liability regimes, are quite serious. Part I described how tort theory divides the costs of accidents into three types, and attempts to minimize each: (1) the primary costs of accidents and preventive measures; (2) the secondary costs of bearing the losses that do occur; and (3) the tertiary costs of administering a system of tort law that tries to reduce primary and secondary costs. As Parts II and III demonstrated, however, tertiary costs cannot be separated from primary costs because tort law's level of deterrence is achieved by the threat of paying *both* for the victim's injury *and* for the costs of litigation.[169] Moreover, because a prevailing plaintiff will receive only that portion of the recovery remaining after legal fees are deducted (generally two-thirds), tort law compensation, and the loss spreading envisioned by tort theory, will be incomplete. As a result, the secondary cost of leaving accident costs upon the individual victim is only partially mitigated by our system of tort law.[170]

This close relationship between tertiary costs, on the one hand, and primary and secondary accident costs, on the other, raises a conceptual problem that this Article has not yet addressed: Are the costs of litigation properly included in the social costs of an accident? On one hand, it would appear that the costs of litigation should be internalized (i.e., borne by tortfeasors). Why should the costs of a lawsuit be distinguished from other expenses (e.g., going to the hospital, taking x-rays, missing work, or repairing a damaged automobile) that arise when someone is injured? When someone is injured, legal expenses are likely to be a part of the costs society bears. Accordingly, they should be included with the primary costs of accidents and actors should take them into account when deciding whether to risk causing the injury in the first place. According to this rationale, tortfeasors should bear not only their own legal expenses, but also those

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169. Indeed, although he does not focus upon it, Calabresi recognizes the connection: "The differences between primary and secondary accident costs are not fixed nor are they always clear. . . . The same is true with respect to tertiary accident costs." CALABRESI, *supra* note 6, at 29.

170. Put another way, a portion of accident costs are never transferred to the entity best able to spread those costs over the relevant activity's beneficiary (the defendant), but instead remain with the plaintiff.

of the plaintiff (and the costs of maintaining the judicial system).[171] Moreover, by compensating tort victims as fully as possible, the tortfeasor's payment of a victim's legal fees would serve to reduce secondary costs as well.

On the other hand, there are equally strong arguments against internalizing all litigation expenses along with the costs of accidents. Although shifting a victim's legal fees to liable tortfeasors may reduce secondary costs, it is far from clear that making a tortfeasor pay litigation costs (either its own, the victim's, or society's) will serve to minimize primary accident costs.

The principal rationale for internalizing accident costs (i.e., making tortfeasors pay) is the minimization of primary accident costs.[172] The law is intended to discourage unreasonably risky behavior and to encourage actors to adopt efficient safety precautions. The law should not, however, encourage excessively costly precautions, nor should it inhibit activities whose benefits outweigh their burdens. Yet, by including litigation costs among the expenses that we fear paying for any injuries we inflict, our system of tort law alters the balance between costs and benefits. Litigation costs may thus transform an efficient activity into an inefficient one.

This effect of litigation costs is not inherently inefficient: if litigation expenses are genuinely part of accident costs, and an activity's total accident costs, *including* litigation expenses, are sufficiently large as to outweigh its benefits, then that activity is, by definition, socially inefficient and, thus, should be deterred.[173] However, unlike other primary accident costs, over which tortfeasors may have control and as to which victims have no incentive to escalate, litigation costs are an element of accident costs that tortfeasors may be unable to minimize.[174]

Ordinarily, a potential tortfeasor may have significant leeway in structuring his activities so as to minimize the costs of both accidents and preventive measures. For example, an electric tool manufacturer may design a fully functional electric saw that guards against major injuries to a user's limbs, but may also find that designing the saw to prevent injuries to fingers would unduly limit the saw's usefulness. In choosing the optimal design for its product, the toolmaker can

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171. The English requirement that the losing tortfeasor pay his victim's attorney's fees is consistent with this sentiment. For a discussion of the various defenses of the English and American rules, see, for example, Rowe, *supra* note 5.

172. *See* CALABRESI, *supra* note 6, at 26; Calabresi & Hirschoff, *supra* note 14, at 1060. General insurance, after all, can compensate individual tort victims and thereby spread accident costs.

173. In fact, if the costs of litigation were factored into the Hand Formula for negligence, some otherwise nonnegligent conduct would become actionable under a negligence standard. *See supra* note 11 (explaining the Hand formula).

174. In contract law, by contrast, contracting parties can minimize the litigation costs of a subsequent breach by including an arbitration clause in the contract. *Cf.* Weston, *supra* note 31, at 930 (describing the effect of Coase's analysis on tort theory and noting that because in the field of tort law "Coasian *ex ante* bargaining . . . is foreclosed in practice by transaction costs, the role of the court is to approximate, through its liability rules, the bargain that those parties would have reached").

weigh the utility of the product against the risk of injuries.[175] Indeed, the toolmaker is in a better position than anyone to judge the relative costs and benefits of a product design. And, because that toolmaker is the "cheapest cost avoider," society can most effectively reduce primary accident costs (i.e., the costs of accidents and preventive efforts) by imposing liability upon that toolmaker.

However, the toolmaker cannot control, ex ante (or even ex post), how much a lawsuit will cost in the case of an injury;[176] it can only try to decrease the likelihood of being sued by making the saw safer.[177] Given that the toolmaker is not in a position to reduce litigation costs, and is by no means the "cheapest cost avoider" with respect to this element of accident costs, it is inefficient to impose these costs upon the toolmaker. The toolmaker will simply respond to higher litigation costs with increasingly safer products. The result will be unreasonably high litigation costs and overdeterrence of beneficial products and activities.[178]

One might expect a similar analysis to apply to other accident costs as well, for defendants likewise lack control over excessive health care costs that have inflated the size of tort claims. But litigation costs are different. As described in Part II, our system of litigation provides plaintiffs with incentives to increase defendants' legal fees—in order to induce defendants to offer more in settlement. A plaintiff's high medical bills, in contrast, will not increase the plaintiff's wealth in a comparable way, for any additional amounts recovered from the defendant to cover medical expenses will be passed on to doctors. Indeed, the plaintiff would actually *lose* money by increasing his out-of-pocket medical expenses, for he must pay his attorney one-third of any additional amounts recovered from the defendant. Thus, although imposing high medical costs on tortfeasors will do nothing to reduce inefficiencies in medical care, it also will not aggravate the problems in health care. In contrast, inefficiencies in the litigation system are actually perpetuated by rules that enable parties to inflict unreasonably high litigation expenses on one another.

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175. *See generally* KEETON ET AL., *supra* note 7, § 99, at 699-700 (describing the risk-utility test for products liability).

176. *See supra* Part II.B.

177. And, even if it opts for the greatest safety possible, it may still face a weak lawsuit from someone who has misused the saw in such an unforeseeable way as to preclude a valid claim, *see* KEETON ET AL., *supra* note 7, § 102, at 712, but who nevertheless hopes to obtain some settlement from the toolmaker.

178. This is not to say that under our system of litigation a defendant's litigation expenses necessarily will exceed what both parties' lawyers and the judiciary would cost in an efficient system. If that were so, then even if defendants paid nothing for meritless cases, litigation costs in meritorious cases (i.e., where causation is established) alone would produce overdeterrence.

Rather, the argument here is that some litigation expense might reasonably be treated *not* as part of the costs of accidents, but rather as costs of rules that govern discovery, fee shifting, and contingent fees. The costs of these rules should, together, be weighed against their collective benefits (e.g., an injured person's access to justice). To the extent that some of these "external" costs are, instead, simply imposed upon defendants, they lead to overdeterrence.

Our tort system's current imposition of high litigation costs is not only inefficient, but also unfair to defendants.[179] Recall that the ethical justification for tort liability requires proof of causation, and that it is not only inefficient, but also unfair, to require a defendant to devote resources to defending and settling lawsuits for injuries that it did not cause.[180] Even where a plaintiff has a meritorious claim and can prove that the defendant caused his injury, however, the defendant's lack of control over its own litigation expenses may be morally troubling.

On one hand, as noted above, litigation costs are one of the social costs of an accident, and the beneficiaries of the activity that caused the accident should therefore bear those costs. On the other hand, it is not clear that unintentional injurers should bear costs that they can neither control nor foresee. Intentional tortfeasors must take their victims as they find them (e.g., if a battery victim dies because of his weak heart, the batterer must accept the consequences).[181] However, there is a long-standing debate over whether merely negligent actors, let alone faultless actors, should bear such unforeseeable costs.[182] Moreover, it seems unfair to burden a defendant with any injury cost for which the plaintiff himself is responsible.[183] Only a flawed system would enable a tort victim to increase his injurer's costs; yet, in our system of litigation, a tort victim can actually improve his bargaining position, and thereby obtain a better settlement, simply by inflicting litigation costs upon the defendant, (e.g., by requesting extensive, unnecessary discovery).[184]

V. PROCEDURAL REFORM

America's combined approach to discovery, fee shifting, and contingent-fee arrangements may help to explain why corporate America despairs at the perceived litigiousness of our society.[185] Repeat defendants, such as large consumer product manufacturers, who face weak, or meritless, lawsuits are disadvantaged by America's combined approach to the above three issues. It is no wonder then that corporations have supported politicians who advocate tort reform, and that anecdotes about the costs of frivolous lawsuits abound.[186] The current hysteria over litigation's ills is justified insofar as the rules discussed

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179. It is also unfair to plaintiffs. To the extent that our litigation rules preclude plaintiffs from paying reasonable attorneys' fees on an hourly basis, and lead them instead to hire contingency attorneys, these rules unfairly deprive plaintiffs of much of the compensation to which they are entitled.

180. *See supra* notes 25-31 and accompanying text.

181. *See* KEETON ET AL., *supra* note 7, § 9, at 40 (stating that "it is better for unexpected losses to fall upon the intentional wrongdoer than upon the innocent victim").

182. *See id.* § 43, at 280 (describing "two basic, fundamental, opposing and irreconcilable views").

183. Such a principle is embodied in the tort doctrines of contributory or comparative negligence, as well as in the contract doctrine of the duty to mitigate one's damages.

184. *See supra* Part II.A-B. Of course, it is equally unfair for defendants to inflict such unreasonably high litigation expenses on plaintiffs.

185. *See* sources cited *supra* note 1.

186. *See generally* sources cited *supra* note 1.

above encourage meritless lawsuits and increase the amounts that repeat defendants expect to pay in legal fees. In short, the procedural backdrop of American litigation may accurately be labeled "antidefendant" when compared to other possible systems.[187]

Yet, the fact that a particular provision may disfavor defendants does not inherently determine whether it fosters an optimal level of deterrence. The manner in which our procedural system disassociates the merits of a case from the costs of litigating it, and lets those costs escalate, may properly be viewed as harmful to efficient deterrence to the extent that it results in a divide between what a defendant expects to pay for his conduct, and how substantive law rules would judge that conduct. But the decision to allow contingent-fee arrangements, which generally benefit plaintiffs, may actually enhance the accuracy of the litigation system, so that settlements better reflect the true economic costs of injuries. Recall that in the absence of contingent-fee arrangements, many of those who are injured would have to forego meritorious claims or accept low settlements.[188] If accurate deterrence is the goal, defendants should not be able to anticipate escaping liability for injuries they inflict simply because they know their risk-averse victims will accept low settlements or will be unable to file suit at all.

The goal of procedural reform, then, should be *not* simply to decrease the amounts that defendants pay for lawsuits, but rather to enhance the accuracy of settlements and eliminate undue legal expenses for both parties. Improved

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187. To evaluate the procedural system's overall impact on defendants' pocketbooks, one would have to examine also the procedural rules that affect settlement amounts by affecting the likely verdict, such as rules governing selection of forum and fact finder—that is, jurisdiction and venue, the right to a jury trial, and jury selection. Although these rules influence settlement amounts as much as the rules addressed by this Article, their effect on settlement often depends upon the facts of particular cases. For example, estimating the effect of a jury versus a bench trial, or a jury pooled from one locality versus another, may often be a matter of speculation about the likely attitude of a particular fact finder toward particular parties and facts.

Nonetheless, if a securities dealer or drug company does business throughout the country and anticipates complicated financial or science-based causes of action, then it will expect long-arm statutes and jury trials to increase its liability. Lawyers generally predict that jurors are more sympathetic to individuals than to large institutions, more sympathetic to locals with similar racial or ethnic backgrounds or with whom they can otherwise identify, and have greater difficulty than judges in evaluating complex commercial or scientific evidence. *See, e.g.*, WALTER F. ABBOTT ET AL., JURY RESEARCH § 4.08, at 22 (1993) ("It is conventional wisdom among attorneys that similarity between client and juror is desirable on the grounds that this similarity encourages identification of the juror with the client."); *id.* § 7.03(d), at 65-66 (summarizing sources on jurors' ability to evaluate complex evidence); Neil Vidmar, *Empirical Evidence on the Deep Pockets Hypothesis: Jury Awards for Pain and Suffering in Medical Malpractice Cases*, 43 DUKE L.J. 217, 218 (1993) ("Physicians, liability insurers, and commentators critical of the American tort system frequently raise the argument that juries are biased against doctors and hospitals."). Although there is debate over the accuracy of many lawyers' assumptions about juries, such as the ones noted above, *see, e.g.*, Kenneth J. Chesebro, *Galileo's Retort: Peter Huber's Junk Scholarship*, 42 AM. U. L. REV. 1637, 1700 & n.293 (1993) (citing sources), the prevalence of these attitudes can affect settlement amounts regardless of whether they are accurate.

188. *See supra* Part III.A-B.

procedural rules would continue to enable plaintiffs to file meritorious cases, but would decrease defendants' exposure to escalated legal fees and meritless cases.[189]

The goals of accurate settlements and reasonable litigation costs do not require the repeal of an entire set of procedural rules. Indeed, if we were simply to reverse our approach in any of the three areas discussed by this Article—that is, to eliminate liberal discovery, to shift fees, or to outlaw contingent-fee arrangements—the cure might be worse than the disease. Absent liberal discovery, outcomes might depart even further from the merits;[190] fee shifting would increase the stakes of litigation and inhibit risk-averse plaintiffs and even their attorneys from filing meritorious claims where there is a risk of losing;[191] and, a ban on contingent-fee arrangements would reduce meritorious filings significantly.[192]

However, because variations in one rule may either counterbalance or reinforce the effects of another, reform may be achieved through adjustment at the margins. For example, the English system has alleviated the hardships of a pure loser-pays fee-shifting regime by implementing programs such as legal aid. Indeed, England's system is not really a pure two-way fee-shifting regime, as a sizeable minority of personal injury plaintiffs qualify for legal aid.[193] Legal aid pays the plaintiff's solicitor and barrister fees, as well as other expenses, and if the plaintiff wins, legal aid is reimbursed by the defendant. If the plaintiff loses, however, neither the plaintiff nor legal aid must pay the defendant's legal fees. Thus, for English plaintiffs who qualify for legal aid (which is much more common in England than in America)[194] the basic two-way fee-shifting regime is converted to a one-way shift.[195]

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189. More efficient litigation rules also might help to ensure that plaintiffs' recoveries are more complete: if litigation were less expensive, some plaintiffs' attorneys might be willing to lower their contingent fees. Moreover, even if attorneys did not lower their fees, they would be willing to accept smaller cases for the same percentage fee. As a result, plaintiffs would be able to buy more effective representation for their money (and plaintiffs with the smallest of cases would have an easier time finding counsel who are willing to represent them).

190. *See supra* Part II.B (noting that if it were not misused, discovery would promote accurate settlement).

191. *See supra* Part III.A (noting the effect of fee shifting on risk-averse plaintiffs). If a fee-shifting regime were structured so that a losing contingent-fee plaintiff's attorney, rather than the plaintiff himself, were forced to bear the prevailing defendant's legal fees, this would alleviate, but not eliminate, the problem. *See* Smith, *supra* note 76, at 2167 ("The risk of indemnification will undoubtedly deter some plaintiffs from pursuing borderline claims, but attorneys burdened with indemnification would reject many such claims anyway.").

192. *See supra* Part III.A.

193. In England, a member of a family earning as much as $45,000 can qualify for legal aid, while in America, a member of a family of four must earn less than $14,562 (or less than $7212 if living alone) in order to qualify. *See* Vargo, *supra* note 76, at 1607 (citing Marianne W. Young, Note, *The Need for Legal Aid Reform: A Comparison of English and American Legal Aid*, 24 CORNELL INT'L L.J. 379, 396 (1991)).

194. *See id.*

195. *See id.* Even if he does not qualify for legal aid, a plaintiff may qualify for trade-union funding, in which case the plaintiff is insulated from all legal fees whether he wins or loses, but the trade union must pay the defendant's legal fees if the plaintiff loses. *See id.* at 1608.

Even where a plaintiff must fund the lawsuit himself, some solicitors in England will take a very promising case on a "spec" basis, under which the solicitor will agree orally not to collect his fees until the conclusion of the case.[196] Such agreements are not officially sanctioned, however, and there is a debate raging over whether to allow "conditional" fees, which would leave the lawyer with nothing if the plaintiff loses, or some multiple of the lawyer's hourly rate if the plaintiff wins.[197]

The United States likewise could retain the core features of its system—contingent fees, liberal discovery, and non-fee-shifting, which ensure "access to justice"—and yet tone down the excesses that unduly prejudice defendants. Reforms should be tailored to address the two problems outlined thus far: (1) the inordinate expenses incurred for meritorious cases, and (2) the problem of expenses for meritless cases. The suggestions that follow do not attempt to exhaust the ways in which we could restructure our system of litigation so as to alter the amounts that defendants pay, and expect to pay, for their conduct. They serve merely as examples of possible procedural changes that might alleviate the problem of overdeterrence caused by America's combined approach to discovery, fee shifting, and contingent-fee arrangements.

First, amendments to Federal Rule of Civil Procedure 68 (and comparable state rules) could reduce unreasonably high litigation expenses in meritorious cases by instituting a partial fee shift after some discovery has been taken and a settlement offer is on the table. Today, Rule 68 modifies the customary practice that losing parties bear court costs (a relatively minor expense). Rule 68 forces a prevailing plaintiff to bear court costs if the plaintiff's verdict is less than the defendant had offered in settlement.[198] Some have advocated extending Rule 68 to include postoffer attorneys' fees, and to cover settlement offers by plaintiffs, so that our general regime of non-fee-shifting would be transformed into a modified fee-

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196. *See id.* at 1607.

197. *Compare Conditions and Fees*, 143 NEW L.J. 1665 (1993) (noting the potential problems of conditional-fee arrangements, including, inter alia, denigration of the legal profession's image, and litigants' loss of significant amounts of money), *with* David Bedingfield, *The Contingency Fee System in America*, 143 NEW L.J. 1670 (1993) (stating that contingency and conditional-fee arrangements open the courthouse door and give injured parties their day in court in as cheap a manner as possible). It is also worth noting that the English fee shift is not a complete fee shift. The courts distinguish between "solicitor-client" costs—the amount the client agrees to pay his attorney—and "party-party" costs—the amount that the court deems necessary to litigate the case. Party-party costs average about two-thirds of solicitor-client costs. *See* Vargo, *supra* note 76, at 1606 (citing GENN, *supra* note 83, at 34). The fact that only party-party costs are shifted decreases somewhat the hardship of losing at trial because the loser need not pay unnecessary fees.

Australia's system represents another hybrid. While Australia has adopted the English fee-shifting rule, Australia moderates this rule by allowing solicitors to accept cases on a "spec" basis, under which they will receive an amount higher than their usual rate if they win (though not a percentage of the amount of the judgment). Moreover, although clients must remain responsible for out-of-pocket legal expenses, solicitors may loan plaintiffs the expenses necessary to pursue their claims. Legal aid, however, is largely unavailable. *See id.* at 1613-17.

198. *See* FED. R. CIV. P. 68.

shifting regime once a settlement offer was on the table.[199] If Rule 68 were amended in this manner, potential defendants would be guaranteed to pay no more than the fair value of a potential lawsuit, because any defendant willing to offer an amount exceeding the ultimate verdict would shift the costs of continued litigation to the plaintiff.[200] Yet, plaintiffs could avoid being coerced into unreasonably low settlements simply by making suitable counteroffers, which defendants would then be inclined to accept for fear of bearing all postcounteroffer legal fees.[201] The Rule might further protect against coercive offers (designed to play upon risk aversion, rather than the merits of a case) by covering only the lesser of the two parties' postoffer legal fees, applying only to settlement offers made after reasonable discovery has been conducted,[202] and then only to offers deemed reasonable by a judge.

Indeed, in order to tie litigation and settlement dynamics more closely to the merits, an amended Rule 68 could extend the formal pretrial role of judges beyond simply deciding whether material issues of fact exist. Instead, the judge would actually weigh the facts to determine whether the parties' offers of settlement were reasonable, who should bear the costs of continuing litigation,

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199. *See* COMMITTEE ON RULES OF PRACTICE AND PROCEDURE, ADMIN. OFFICE OF THE U.S. COURTS, PRELIMINARY DRAFT OF PROPOSED AMENDMENTS TO THE FEDERAL RULES OF CIVIL PROCEDURE (1983), *reprinted in* 98 F.R.D. 337, 361-63 (1983) (proposing amendments to Federal Rule of Civil Procedure 68); Rowe, *supra* note 5, at 895-96; Mary A. Hackett et al., Note, *Rule 68: An Offer You Can't Afford to Refuse*, 37 RUTGERS L. REV. 373, 379-82 (1985) (comparing the federal rule with N.J. CT. R. 4:58).

Geoffrey Miller and David Anderson have provided an economic analysis of such a modified Rule 68. *See* Anderson, *supra* note 83, at 236-40; Miller, *supra* note 83, at 117-25. Although economic modeling casts doubt upon the ability of Rule 68, and its various permutations, to encourage settlement where parties otherwise would not settle, *see* Anderson, *supra* note 83, at 240, this Article endorses amendments to Rule 68, *not* in order to encourage additional settlements (which are sufficiently prevalent), but rather to promote more accurate deterrence. A modified Rule 68 could contribute to this goal by assuring defendants ex ante that their tort-related payments ex post will depend upon the merits of cases, rather than upon the expense of litigation.

200. It is true that under a modified Rule 68, defendants would structure their behavior ex ante based not only on the likelihood of winning lawsuits (which would be a positive development) but also on the likelihood that they will be able to make accurate settlement offers in meritorious cases and thereby evade much of litigations's expense. *See generally* Calfee & Craswell, *supra* note 4 (describing effects of uncertainty on compliance levels of potential defendants). But if defendants are at all able to predict the likely costs and benefits of their actions ex ante (as our tort system assumes they can) then defendants should have some confidence in their ability to estimate a victim's injuries (and the jury's likely verdict) once those injuries have occurred. *But cf.* Gross & Syverud, *supra* note 100, at 46-50 (seeking to explain why trial outcomes generally do not strike a compromise between parties' settlement positions).

201. *Cf.* Miller, *supra* note 83, at 123-25. Plaintiffs and their attorneys would be free to work out for themselves who would bear defendants' postoffer fees in case of a loss, and to adjust their fee arrangement accordingly.

202. *See* Hackett et al., *supra* note 199, at 399.

and on what terms.[203] As a result, parties would have incentives to conduct discovery quickly and efficiently so that they could evaluate the merits before settlement offers were exchanged under judicial supervision.

If a judge were to decide that a settlement offer was inconsistent with the merits, or that additional discovery was needed before its suitability could be determined, then each party would continue to bear its own legal fees.[204] However, an additional reform might empower the judge to decide that if one party or the other still had not uncovered the evidence it required after a certain level of discovery expense was reached, then that requesting party would have to reimburse its opponent for any future requests.[205]

Such reforms would decrease litigation expenses associated with meritorious cases, but would not necessarily protect defendants from meritless claims. Knowing that fee shifting would not kick in until after defendants already had devoted some resources, plaintiffs' attorneys might continue to file weak or meritless cases with little investigation in the hope that defendants will settle *before* a reasonable level of discovery is reached and a judge has approved the onset of fee shifting.

In order to reduce defendants' expenses for meritless cases, the system would have to shift fees incurred from the outset—as Federal Rule of Civil Procedure 11 enables a judge to do.[206] The problem is that judges are reluctant to award

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203. Although parties would retain the right to proceed to trial, the judge would essentially decide that if they do so and do not improve their position, they should bear the full costs of their decision to proceed. *Cf.* Alschuler, *supra* note 107 (proposing a two-tier trial system in which a magistrate or master would conduct an abbreviated trial and parties would have the right to pursue fuller discovery and a jury trial, but the parties would also be required to bear the government's costs of trial if they did not improve their position). Permitting judges to weigh evidence would not be unprecedented, as judges have long been empowered to weigh evidence when setting aside verdicts and granting new trials. *See* Young B. Smith, *The Power of the Judge to Direct a Verdict: Section 457-a of the New York Civil Practice Act*, 24 COLUM. L. REV. 111, 116-17 (1924) (chronicling the history of new trials and directed verdicts and discussing a New York rule that would allow judges to weigh evidence even when directing a verdict).

204. If, for example, a defendant were to offer one dollar to settle a meritorious, but close, case, this would not entitle him to all postoffer legal fees if he wins.

205. *See* Cooter & Rubinfeld, *supra* note 60, at 455-57.

206. In the law and economics literature Bebchuk and Chang, and Polinsky and Rubenfeld have modeled various forms of sanctions for frivolous litigation and Marshall, Kritzer, and Zemans provide empirical background confirming the effectiveness of Rule 11. *See* Bebchuk & Chang, *supra* note 76; Marshall et al., *supra* note 105; A. Mitchell Polinsky & Daniel L. Rubenfeld, *Sanctioning Frivolous Suits: An Economic Analysis*, 82 GEO. L.J. 397 (1993). In order to provide plaintiffs with appropriate incentives to bring meritorious but not meritless suits, Bebchuk and Chang advocate a Rule 11 regime that takes into account not only the strength or weakness of a claim, but a plaintiff's incentive to bring the claim in the first place; sanctions thus would be imposed less frequently for categories of lawsuits that are socially useful but expensive for plaintiffs to pursue. *See* Bebchuk & Chang, *supra* note 76, at 394-402. Polinsky and Rubenfeld propose a regime of "decoupled" sanctions in which the moving party receives a portion of any sanction imposed upon his opponent, and the judicial system receives the remainder; this would provide parties with incentives to bring bad acts to the court's attention and thus achieve efficient deterrence of frivolous suits, but would avoid inducing parties to devote too much effort to satellite Rule 11 litigation. *See* Polinsky & Rubenfeld,

legal fees as a sanction for meritless cases.[207] When a judge examines the evidence produced by discovery and concludes that there is no outstanding issue of material fact and the defendant is entitled to judgment as a matter of law, this does not mean that the complaint was filed in bad faith or "for any improper purpose."[208] Indeed, Part III.D demonstrated that while some meritless suits may be filed by plaintiffs' attorneys who know they are meritless, many more are filed because plaintiffs' attorneys take on more cases than they have time to investigate.

The 1983 amendments improved Rule 11 by instructing a judge to impose sanctions if the plaintiffs' attorney did not engage in "reasonable inquiry" before filing the complaint.[209] Under the revised rule, the plaintiffs' attorney was required to conduct his own inquiry before imposing any investigation costs upon the defendant; *if* "reasonable inquiry" could have uncovered evidence establishing the meritlessness of a claim before filing, then there was no need for discovery and the plaintiffs' attorney should reimburse the defendant for his expenses. The 1993 amendments, however, expressly protected a plaintiff's ability to base a claim on "information and belief" rather than evidentiary support, and created a "safe harbor" in which plaintiffs may withdraw allegations without being subject to Rule 11 sanctions.[210] This created a concern that "some litigants may be tempted to conduct less of a pre-filing investigation."[211]

There is nothing objectionable in making express a plaintiff's long-standing right to plead on "information and belief"—any other rule would eliminate the

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supra, at 417-19. Marshall, Kritzer, and Zemans conducted lawyer surveys revealing that in practice Rule 11 does *not* give rise to inordinately expensive satellite litigation and thus is an efficient way to deter frivolous claims and defenses. *See* Marshall et al., *supra* note 105, at 958-60, 985. Indeed 60% of attorneys reported that in the preceding year thay had altered their behavior (e.g., by foregoing a claim or defense or conducting additional review) because of the threat of sanctions posed by Rule 11. *See id.* at 960-61.

207. The willingness of judges to impose Rule 11 sanctions (and parties to move for them) varies from district to district. *See* Marshall et al., *supra* note 105, at 976-79. Rule 11 sanctions are imposed more frequently in metropolitan areas than in nonurban or mid-sized urban districts. *See id.* This may be due to the differences in attorney conduct and corresponding differences in the need for Rule 11 sanctions, or else to different thresholds before Rule 11 sanctions will be imposed. Although the survey suggests that "a good degree of lawyerly reaction to Rule 11 is not tailored to the actual risk that lawyers face but is based more on general reaction to the rhetoric about the threats that the Rule creates," *id.* at 978-79, this Article proposes a Rule 11 standard that may contribute to a more uniform application of the Rule throughout the nation.

208. FED. R. CIV. P. 11.

209. *See* 2 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE § 11App.101[2] (3d ed. 1997) (explaining how the 1983 amendment changed the standard of conduct an attorney must follow from subjective good faith to an objective standard of conduct).

210. Committee on Rules of Practice and Procedure, Attachment B to Letter from Sam C. Pointer, Jr., Chairman, Advisory Committee of Civil Rules, to Hon. Robert E. Keeton, Chairman, Standing Committee on Rules of Practice and Procedure (May 1, 1992), *reprinted in* SUPREME COURT OF THE U.S., AMENDMENTS TO FEDERAL RULES OF CIVIL PROCEDURE AND FORMS, H.R. DOC. NO. 103-74 (1993), *reprinted in* 146 F.R.D. 401, 522-25 (1993).

211. *Id.* at 524 (offering notes regarding proposed amendments to Federal Rule of Civil Procedure 11).

utility of discovery by requiring plaintiffs to have all relevant facts in hand upon filing a complaint. (Nor is there anything inherently wrong with encouraging plaintiffs to withdraw meritless claims upon learning of their defects.[212]) The appropriate question, however, is when and to what extent defendants should have to pay for plaintiffs to investigate allegations that ultimately never find evidentiary support. Although the system should encourage plaintiffs to file suits where they reasonably expect discovery to uncover supporting evidence, a rule that requires defendants to pay for discovery in every case also encourages plaintiffs to file suits (and receive settlements) where discovery is unlikely to reveal supporting evidence.[213]

To encourage meritorious suits but discourage meritless ones, Rule 11 jurisprudence might borrow principles from substantive negligence law. By filing a losing lawsuit, after all, plaintiffs and their attorneys themselves become the tortfeasors in a sense, causing unlawful injury to defendants.[214] The English fee-shifting model imposes strict liability for losing lawsuits by requiring the plaintiff to compensate the defendant regardless of whether the plaintiff could have known at the outset that his suit was meritless. Rule 11, in contrast, imposes only negligence liability, requiring plaintiffs to engage in reasonable investigation of the facts before filing, but refusing to shift the expense of a losing lawsuit if the plaintiff reasonably believed it to have merit. The United States' decision to impose negligence, rather than strict liability, for losing lawsuits reflects the United States' commitment to preserving access to justice and fear of inhibiting meritorious claims. However, if Rule 11 is really to impose negligence liability (as opposed to punishing only intentional wrongdoing) plaintiffs' attorneys should be required not only to investigate their clients' allegations before filing, but also at least to consider the costs of discovery for any unsupported allegations that remain.[215] This is not to say that the reasonableness inquiry necessarily requires a strict weighing of likely discovery costs against the likely recovery (in the case of a victory for the plaintiff). Because society benefits from the filing of small, meritorious claims—even if the costs outweigh the benefits for the particular parties involved—plaintiffs should be permitted to pursue claims with

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212. *But see* AMENDMENTS TO THE FEDERAL RULES OF CIVIL PROCEDURE (Scalia, J., dissenting) (criticizing safe harbor), *in* SUPREME COURT OF THE U.S., *supra* note 211, *reprinted in* 146 F.R.D. at 507-08.

213. Survey evidence reveals that the threat of Rule 11 sanctions led 32.3% of plaintiffs' attorneys to conduct "*extra* prefiling review of pleadings, motions or other documents subject to Rule 11," as compared to 39.6% of defendants' attorneys (who have incentives in any event to work additional hours where they are paid by the hour). Marshall et al., *supra* note 105, at 962-64 (emphasis in original). Although Rule 11 as currently applied thus has a significant effect on attorney behavior, this Article's proposed increase in emphasis on prefiling investigation might lead plaintiffs' attorneys even more often to avoid filing potentially meritless lawsuits without learning enough first to know whether discovery is reasonably likely to reveal supporting evidence.

214. In contrast, defendants themselves bear responsibility for meritorious suits.

215. *See supra* note 137 (describing uninformed plaintiffs' incentives to shift investigation costs to defendants by filing lawsuits and thereby becoming entitled to discovery).

substantial social benefits.[216] However, if discovery is unlikely to reveal supporting evidence for an allegation, then the attorney's decision to include that allegation in his initial complaint—and thereby to inflict costs upon the defendant—should not be deemed reasonable. Plaintiffs and attorneys should pay compensation if their hope of uncovering supporting evidence was unreasonable from the outset and is proven to be unreasonable by subsequent discovery.

Finally, Rules 11 and 26 could work together to ensure not only that complaints contain only the allegations for which discovery might reasonably find support, but also that the discovery subsequently requested is reasonably tailored to find support for these allegations.[217] Indeed, a plaintiff could be forbidden from asking for broad discovery of evidence potentially relevant to various aspects of a lawsuit until he has first conducted narrow discovery tailored to uncover the evidence he will need to withstand summary judgment on unsupported allegations in his complaint.[218] By limiting the expense defendants must bear in the early stages of litigation, such reforms would reduce defendants' incentives to settle meritless lawsuits, and thus plaintiffs' incentives to file them.

CONCLUSION

Part I of this Article explored how tort law could achieve its goals—efficient and fair deterrence and compensation—in a hypothetical world in which defendants' conduct is judged solely according to substantive law. Parts II and III demonstrated that real world litigation skews the incentives posited by the theoretical model. In fact, litigation costs play such a significant role that they may well overshadow the merits when plaintiffs decide to file, and parties decide to settle, lawsuits. Part II focused on two features of American litigation—the rules governing discovery and fee shifting—that together lead parties to bear unreasonably large litigation costs, beyond their control, regardless of the merits. Part III then demonstrated that the availability of contingent-fee arrangements ensures that these high legal fees do not induce plaintiffs to forego meritorious

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216. *See* Bebchuk & Chang, *supra* note 76, at 394-402 (suggesting that Rule 11 analysis consider a plaintiff's initial incentives to file or forego different types of legal claims, so that sanctions discourage abusive suits without inhibiting desirable, though perhaps novel or expensive, claims); *see also* Hay, *supra* note 60, at 483 (noting that private incentives and social incentives may differ, and that even if a discovery request does not increase the value of the requesting party's claim sufficiently to justify its cost, the request may nevertheless be socially efficient if it induces defendants to take precautions against inflicting harm); *cf.* Bone, *supra* note 129, at 591-92 (noting that in the informed-defendant model, only a modest penalty is needed to deter frivolous suits, and that excessive penalties might inhibit weak but meritorious claims).

217. *See* Sofaer, *supra* note 67, at 723 (noting that "[d]iscovery is . . . made costly because of the legal theories on which courts have permitted suits to proceed" and because "plaintiffs [may] file complaints in which they need do little more than allege an injury that is believed to have resulted from some dangerous instrumentality or activity, . . . [a practice which] will generally entitle them to search for an explanation through discovery").

218. *But cf.* Sugarman & Perlin, *supra* note 66, at 1482 (criticizing the Council on Competitiveness's recommendation tying discovery requests to pleadings, and calling it "a rule departing from notice pleading and renewing reliance on factual allegations").

claims or settle them routinely for less than the merits warrant. Rather, the combined effect of the three sets of rules is to lead defendants to pay not only fair settlements for the injuries they inflict, but also significant litigation expenses in meritorious cases and significant amounts to dispose of meritless cases. In short, defendants must pay more for their conduct than they would if they looked to substantive law alone.

Part IV then showed how these practicalities of litigation and settlement alter the tort law deterrence envisioned by theorists in two important ways. First, by allowing the filing and settlement of meritless lawsuits, our system of litigation deters productive conduct that does not even cause injury. Second, when unreasonably high litigation costs are inappropriately factored into the costs of accidents, the tort system fails to minimize total accident costs and instead deters efficient conduct.

Finally, Part V suggested that Rule 68 might be amended so as to tie litigation and settlement dynamics more closely to the merits, and that Rules 11 and 26 might be applied in such a way as to protect defendants from meritless filings.