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# Illuminating Secrecy: A New Economic Analysis of Confidential Settlements

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# ILLUMINATING SECRECY: A NEW ECONOMIC ANALYSIS OF CONFIDENTIAL SETTLEMENTS

### Scott A. Moss*

*Even the most hotly contested lawsuits typically end in a confidential settlement forbidding the parties from disclosing their allegations, evidence, or settlement amount. Confidentiality draws fierce criticism for harming third parties by concealing serious misdeeds like discrimination, pollution, defective manufacturing, and sexual abuse. Others defend confidentiality as a mutually beneficial pay-for-silence bargain that facilitates settlement, serves judicial economy, and prevents frivolous copycat lawsuits. This debate is based in economic logic, yet most analyses have been surprisingly shallow as to how confidentiality affects incentives to settle. Depicting a more nuanced, complex reality of litigation and settlement, this Article reaches several conclusions that are quite different from the economic conventional wisdom—and absent from the existing literature. First, contrary to the conventional wisdom that banning confidentiality would inhibit settlement, a ban could promote early settlements. No ban could effectively cover settlements reached before litigation, so any ban would incentivize parties to settle confidentially prefiling—and such early settlements save more litigation costs. Second, a ban would affect high- and low-value cases differently, depending on whether publicity-conscious defendants worry more about one big settlement or several small ones. Third, more settlement data would decrease litigation uncertainty, helping parties settle and deterring frivolous lawsuits. Fourth, more data would also reveal unlawful practices, yielding more efficient decisions by consumers, workers, and investors who otherwise engage in over-avoidance when unable to distinguish hazardous from safe goods. Contrary to the traditional economic story, we cannot predict the net effect of all these competing effects. Economics thus does not counsel against a confidentiality ban. This analysis typifies the schism between traditional economic analyses, which reach definite conclusions by simplifying complex realities, and many contemporary economic analyses, which are realistically nuanced but do not yield categorical conclusions. The latter brand of economics is sounder and still can clarify important matters such as parties' incentives, rules' costs and benefits, and the tradeoffs and competing effects of a policy like a confidentiality ban.*

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## INTRODUCTION: A CONFIDENTIALITY CONTROVERSY
## IN NEED OF ECONOMIC ANALYSIS

Lawsuits are tales that begin with great fanfare and suspense, with fire-and-brimstone pleadings telling dueling stories of injustice and lies, followed by contentious pretrial battles. Yet most lawsuits are tales that end abruptly, with a whimper of a one-page "voluntary dismissal" that ends the dispute without explanation, making it appear "that the plaintiff simply gave up."[1] "[S]ettlement terms are usually not reflected in court documents,"[2] instead appearing only in settlement documents broadly forbidding the parties from discussing their allegations, evidence, or settlement amount.[3] *Public* settlements are the exception, common in only a few types of cases such as class actions[4] and some cases with governmental defendants[5] or plaintiffs.[6]

Courts regularly allow confidentiality provisions; indeed, under existing law, they *cannot* force parties to disclose settlement terms they had agreed to keep confidential.[7] A few jurisdictions restrict confidentiality[8] in the small

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1.    Minna Kotkin, *Invisible Settlements, Invisible Discrimination*, 84 N.C. L. REV. 927, 929 (2006). Federal Rule of Civil Procedure 41(a) provides the preferred way for parties to dismiss a case voluntarily, by filing a simple dismissal stipulation.

2.    Boone v. City of Suffolk, 79 F. Supp. 2d 603, 607 (E.D. Va. 1999).

3.    *E.g.*, Confidential Settlement Agreement and General Release ¶ 9 (template, on file with author) ("[T]his Agreement, as well as the nature and terms of this settlement and the subject matter thereof, will be forever . . . confidential . . . . The parties] shall make no disclosure or reference to the terms of this Agreement to any person."). It is hard to cite an actual confidential settlement, because they are secret; this form is typical and at least two major law firms were using it.

4.    Class action settlements must be disclosed to class members and scrutinized by the court. FED. R. CIV. P. 23(e). *See, e.g.*, Martens v. Smith Barney, 181 F.R.D. 243 (S.D.N.Y. 1998) (rejecting settlement proposed by the parties but opposed by some class members and amicus curiae).

5.    In some states, "public entit[ies] cannot enter into . . . confidentiality" agreements "with respect to public records." State *ex rel.* Sun Newspapers v. Westlake Bd. Of Educ., 601 N.E.2d 173, 175 (Ohio Ct. App. 1991) (quoting State *ex rel.* Allright Parking of Cleveland, Inc. v. City of Cleveland, No. 57881, 1991 WL 30252, at *2 (Ohio Ct. App. Mar. 1, 1991)). For an example of such a settlement, see Sherry v. N.Y. Med. Coll., No. 99-CV-2310, 2000 WL 781867 (S.D.N.Y. June 19, 2000) (ordering the defendant city to pay the plaintiff $129,975.20).

6.    Kotkin, *supra* note 1, at 927 (noting an Equal Employment Opportunity Commission practice of requiring settlements to be filed publicly in court). For an example of such a settlement, see EEOC v. Morgan Stanley & Co., No. 01-CV-8421, 2004 WL 1584938 (S.D.N.Y. July 12, 2004) (sex discrimination consent decree with terms including "Total Settlement Amount of $54 million").

7.    Courts cannot force parties to disclose their settlement terms. Federal Rule of Civil Procedure 41 "does not . . . empower . . . court[s] to attach conditions to the parties' stipulation of dismissal," Kokkonen v. Guardian Life Ins. Co. of Am., 511 U.S. 375, 381 (1994), and district courts that try to force disclosure of confidential settlement terms are always reversed, *see, e.g.*, Gambale v. Deutsche Bank AG, 377 F.3d 133, 144 (2d Cir. 2004) ("[I]t was a serious abuse of discretion for the district court to refer to the magnitude of the settlement amount—theretofore confidential . . . ."); Smith v. Phillips, 881 F.2d 904, 906 (10th Cir. 1989) ("[U]nder [Rule 41,] the stipulation of dismissal divested the district court of any jurisdiction it might have had to order the settlement agreement made public.").

8.    *E.g.*, DIST. S.C. LOCAL CIV. R. 5.03(E) ("No settlement agreement filed with the Court shall be sealed . . . ."); *see* ROBERT TIMOTHY REAGAN ET AL., SEALED SETTLEMENT AGREEMENTS IN FEDERAL DISTRICT COURT 2–3 (2004) (collecting court rules, no others of which ban sealing).

number of confidential settlements filed in court under seal,[9] but none broadly ban settlement confidentiality,[10] and proposals for broader restrictions have not yet succeeded.[11] Most courts accept this state of affairs not reluctantly but eagerly, disclaiming any power over settlement[12] and praising " '[s]ecrecy of settlement terms . . . [as] a well-established American litigation practice.' "[13]

With so many lawsuits beginning with allegations of grievous social harm but ending with the legal equivalent of "never mind," confidential settlements have drawn increasingly fierce criticism recently, attacked as ways defendants conceal serious misdeeds such as dissemination of hazardous products,[14] discrimination,[15] pollution,[16] or sexual abuse.[17] These critiques

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9.   Confidential settlements are filed in under 0.5% of federal cases. REAGAN ET AL., *supra* note 8, at 1.

10.   Florida's Sunshine in Litigation Act and Louisiana's virtually identical rule are the two broadest of the few state laws restricting private confidentiality. *See* Richard A. Zitrin, *The Laudable South Carolina Court Rules Must Be Broadened*, 55 S.C. L. REV. 883, 891–95 (2004) (collecting state laws). However, even Florida's law covers only settlements "concealing . . . information concerning a public hazard" and "that has caused and is likely to cause injury," FLA. STAT. ANN. § 69.081(2), (4) (West 2004), and this language limits the law to (1) only hazards that have *already* caused *and* are *still likely* to cause injuries and (2) only "health and safety" hazards, not harms like financial fraud, *see* State Farm Fire & Cas. Co. v. Sosnowski, 830 So. 2d 886, 887–88 (Fla. Dist. Ct. App. 2002).

11.   Zitrin, *supra* note 10, at 895 (recounting failure of federal proposals).

12.   *E.g.*, United States v. Altman, 750 F.2d 684, 696 (8th Cir. 1984) ("Courts not only frown on interference by trial judges in parties' settlement negotiations, but also renounce the practice of approving parties' settlement agreements"); United States v. City of Miami, 614 F.2d 1322, 1330 (5th Cir. 1980) (explaining that the parties are free to settle if they can agree to terms, while the judge's role is to resolve issues brought to him and to stay indifferent when the parties settle).

13.   Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc., 332 F.3d 976, 980 (6th Cir. 2003) (quoting Palmieri v. New York, 779 F.2d 861, 865 (2d Cir. 1985)).

14.   *E.g.*, David Luban, *Settlements and the Erosion of the Public Realm*, 83 GEO. L.J. 2619, 2650 (1995) (noting that defective products that were allegedly hidden include "Dow Corning's silicone gel breast implants; pickup trucks made by Ford and General Motors; Upjohn's sleeping pill Halcion . . . and McNeil Pharmaceutical's painkiller, Zomax."). Laurie Kratky Doré recounts similarly:

> The recall of over fourteen million potentially dangerous tires . . . came eight years after . . . lawsuits concerning a tire . . . linked to over two hundred and fifty deaths . . . . Many of those Firestone cases were kept secret . . . . GM's side-mounted gas tanks, the Dalkon shield, the Shiley heart valve, and . . . environmental hazards flew[ ] below public radar cloaked by . . . settlements.

Laurie Kratky Doré, *Settlement, Secrecy, and Judicial Discretion: South Carolina's New Rules Governing the Sealing of Settlements*, 55 S.C. L. REV. 791, 792 (2004)

15.   *See, e.g.*, Kotkin, *supra* note 1, at 930 ("The whole thrust of equal employment legislation was that . . . discrimination would be brought to public attention . . . .").

16.   *See, e.g.*, Andrew F. Daughety & Jennifer F. Reinganum, *Informational Externalities in Settlement Bargaining; Confidentiality and Correlated Culpability*, 33 RAND J. ECON. 587, 587–589 (2002) (recounting later-disclosed sealed settlement in toxic tort case alleging gasoline leaks into a community's drinking water).

17.   Christopher R. Drahozal & Laura J. Hines, *Secret Settlement Restrictions and Unintended Consequences*, 54 KAN. L. REV. (forthcoming Nov. 2006) (manuscript at 1, on file with author) (recounting settled and sealed child sex abuse cases involving priests years before clergy child abuse was widely known).

build upon the broader view "Against Settlement" (the title of the famous article) that settlement sacrifices many virtues of our justice system on the altar of convenience.[18]

Defenders of confidential settlements offer a range of arguments. From the free-market right-to-contract perspective, confidentiality facilitates mutually beneficial settlement deals: defendants value and pay for confidentiality; plaintiffs gladly accept money for their silence.[19] From the judicial economy perspective, judges candidly admit supporting any pro-settlement practice that lightens their dockets,[20] and disclosing settlements could spur more lawsuits by making defendants look like easy targets.[21] From the legal ethics perspective, parties hire lawyers to resolve *their* disputes on the best terms, not to serve a broader social good by rejecting advantageous money-for-silence offers.[22]

On all sides of the debate, however, the economic logic has been surprisingly shallow as to how confidentiality affects parties' settlement incentives.[23] The pro-confidentiality economic analysis is just that bad publicity is a non-monetary cost defendants pay to avoid and that settlements

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18.   Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073, 1075 (1984) ("I do not believe that settlement as a generic practice is preferable to judgment . . . . [It is] a highly problematic technique for streamlining dockets . . . . Consent is often coerced . . . justice may not be done . . . . [S]ettlement is a capitulation to the conditions of mass society and should be neither encouraged nor praised.").

19.   *See infra* note 59 and accompanying text.

20.   "I would sign an order that stipulated that the moon was made out of cheese if the lawyers . . . asked" in a settlement, one judge colorfully admitted. Joseph F. Anderson, *Hidden from the Public by Order of the Court: The Case Against Government-Enforced Secrecy*, 55 S.C. L. REV. 711, 729–30 (2004) (quoting another judge: "If I did not go along, [settlement] . . . would fall apart . . . [yielding] a six-month trial."); *see also* Arthur R. Miller, Jr., *Confidentiality, Protective Orders, and Public Access to the Courts*, 105 HARV. L. REV. 427, 486 (1991) (arguing against requiring settlement disclosure because "[c]onfidentialities . . . are bargained-for elements of settlement agreements . . . . [There is a] strong public interest in . . . promoting settlement . . . . [which] helps free valuable judicial resources . . . . [The] justice system could not bear the increased burden . . . [of] reducing the frequency of settlement or delaying" it.).

21.   *See infra* notes 52–54 and accompanying text.

22.   *See* Luban, *supra* note 14, at 2624–25 (noting the legal ethics view that attorneys must "maximize a client's outcome" regardless of effects on others). *Compare* Heather Waldbeser & Heather DeGrave, Current Development, *A Plaintiff's Lawyer's Dilemma: The Ethics of Entering a Confidential Settlement*, 16 GEO. J. LEGAL ETHICS 815, 826 (2003) ("[Z]ealous representation . . . . [requires] attorney[s] . . . [to] enter into a confidential settlement agreement if it best serves the client [ ] . . . ."), *with* Zitrin, *supra* note 10 (arguing, based on legal ethics, against settlements limiting information about public harms).

23.   The only serious economic study of confidential settlements is a series of three excellent articles co-authored by two economists, Andrew F. Daughety and Jennifer F. Reinganum, all three of which focus on matters much more limited than this Article. Andrew F. Daughety & Jennifer F. Reinganum *Hush money*, 30 RAND J. ECON. 661 (1999) (demonstrating through modeling that, under most circumstances, parties have incentives to keep settlements confidential, to the potential detriment of third parties, and discussing whether, on average, confidentiality makes settling parties better or worse off) [hereinafter Daughety & Reinganum, *Hush money*]; Daughety & Reinganum, *supra* note 16 (addressing the same issues as the authors' 1999 article but varying certain assumptions); Andrew F. Daughety & Jennifer F. Reinganum, *Secrecy and Safety*, 95 AMER. ECON. REV. 1074 (2005) (noting how confidentiality lets manufacturers avoid remedying product defects, potentially decreasing consumer demand, and how "good" manufacturers might support a confidentiality ban) [hereinafter Daughety & Reinganum, *Secrecy and Safety*].

decrease litigation costs. The anti-confidentiality view usually is cast in moral terms[24] but sometimes is explained economically: confidentiality leaves unredressed the social harms that led to the lawsuit (e.g., toxic dumping), imposing negative externalities,[25] costs borne by third parties.[26] Though logical, both sides' economic slogans fail to depict the far more nuanced, complex reality of litigation and settlement.

This Article seeks to fill the void in the economic thinking about confidential settlements. It aims to improve upon the largely superficial economic debate so far—"efficiently increasing settlement" versus "inefficiently imposing externalities"—and, in doing so, reaches quite different findings about the incentive effects of a confidentiality ban. Part I reviews the traditional economic model of when cases settle and its view that confidentiality increases the incentive to settle. Part II then presents novel economic analyses that depict a reality more complex than, and often contrary to, those of the traditional model.

Sections II.A and II.B note two key distinctions absent from the traditional model. Section II.A shows how banning confidentiality actually may *promote* settlements: a ban could not effectively cover settlements reached *before* litigation, so a ban reaching only postfiling settlements would yield more confidential prefiling settlements. This pre-/postfiling distinction is an example of unintuitive, unintended consequences resulting from a regulation having gaps in its coverage. Section II.B then analyzes how a ban would affect high- and low-value cases differently, depending on whether publicity-conscious defendants worry more about one big settlement or several small ones.

Sections II.C and II.D discuss two informational benefits of increased settlement disclosure. Section II.D notes litigation benefits: knowing prior cases' settlement amounts would help parties determine their own settlement value, and decreasing litigation uncertainty could decrease frivolous lawsuits. Section II.D notes benefits in labor, consumer, and investment markets: more information about which companies pay more in settlements could lessen the problem of those who are under-informed rationally "over-

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24.  *See, e.g.,* Kotkin, *supra* note 1, at 947 ("[T]he backbone of the argument against confidentiality [is] the right of the public to know . . . .").

25.  *See* ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 590 (3d ed. 1995) (defining externalities).

26.  David A. Dana & Susan P. Koniak, *Secret Settlements and Practice Restrictions Aid Lawyer Cartels and Cause Other Harms,* 2003 U. ILL. L. REV. 1217, 1232 (criticizing secrecy as "resulting in the needless injury of more people"); Drahozal & Hines, *supra* note 17, at 115 ("The principal argument against secret settlements . . . . [is that they] harm the public by suppressing information about health and other hazards."); Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System,* 26 J. LEGAL STUD. 575, 605 (1997) ("[S]ociety would benefit from . . . information . . . . [from a] firm that wants to keep its product defect secret . . . ."); Zitrin, *supra* note 10, at 887 (explaining the value of restricting confidentiality in section entitled, "Absent Stronger Rules, Secrecy Will Continue to Endanger the Public"); Alison Lothes, Comment, *Quality, Not Quantity: An Analysis of Confidential Settlements and Litigants' Economic Incentives,* 54 U. PA. L. REV. 433, 434–36 (2005) ("[T]he real problem . . . [is] divergence between societal and individual costs and benefits . . . . [S]ecrecy threatens to perpetuate unexposed danger, imposing costs upon others . . . .").

avoiding" jobs, goods, or investments that *might* be dangerous. Avoiding a whole industry because of a few bad apples, people may shift to inferior alternatives, all because of an information problem—inability to determine which of the apples are good and which are bad—that more settlement disclosure would help remedy.

Overall, Part II shows that a confidentiality ban's effect of decreasing postfiling settlements would be offset by more prefiling settlements. Even if settlements decreased (on the net), prefiling settlements save more litigation costs, so total costs might decrease; even if costs do not decrease, a ban might have efficient dynamic effects, such as deterring frivolous lawsuits and improving market decisions. Notwithstanding these desirable effects, the presence of so many opposing forces precludes easy prediction of the net effect—contrary to the traditional model's simple, conclusive story. A jurisdiction banning confidentiality thus would be undertaking a worthy experiment with a promising but uncertainty-clouded policy.

## I. THE ECONOMICS OF LITIGATION AND SETTLEMENTS, CONFIDENTIAL AND OTHERWISE

Economic modeling of litigation has long been a staple of economic analysis of law.[27] Recently, numerous scholars have modified traditional economic models of litigation in various ways, such as by applying cutting-edge modeling methods,[28] applying modern social science theories of human behavior,[29] or applying traditional models in novel ways.[30] Nevertheless, even the most creative models are essentially tweakings of the traditional model, which remains the starting point for any meaningful economic thinking on litigation.

The traditional economic model of litigation predicts that all cases will settle.[31] However, settlement often occurs late in the litigation process, or not at all, for various reasons. Most relevant for present purposes, settlement may occur late or not at all when, due to optimism and/or incomplete

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27.  *See, e.g.*, ROBERT G. BONE, CIVIL PROCEDURE: THE ECONOMICS OF CIVIL PROCEDURE 20–40 (2003); ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 392–99 (4th ed. 2004); A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 135–46 (3d ed. 2003); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 563–606 (6th ed. 2003).

28.  *E.g.*, Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 STAN. L. REV. 1267, 1270–71 (2006) (modeling litigation with "real options theory," one of "the tools applied to the economic analysis of research and development projects").

29.  *E.g.*, Ward Farnsworth, *Do Parties to Nuisance Cases Bargain after Judgment? A Glimpse Inside the Cathedral, in* BEHAVIORAL LAW AND ECONOMICS 302 (Cass R. Sunstein ed., 2000) (applying behavioral economics to analyze why parties fail to bargain after cases end).

30.  *E.g.*, David Rosenberg & Steven Shavell, *A Simple Proposal to Halve Litigation Costs*, 91 VA. L. REV. 1721 (2005) (proposing the halving of litigation costs by only litigating a randomized half of all cases brought before courts, but awarding double damages in those cases that are litigated).

31.  *See infra* Section I.A.1.

information, the parties have divergent beliefs as to the merits of the claim.[32]
Confidentiality of settlements, in the traditional model, is an important in-
ducement to the defendant to settle (and to offer more in settlement) because
it allows the defendant to avoid costly public disclosures of negative infor-
mation.[33] Banning confidentiality would decrease the amounts defendants
offer in settlement, thereby decreasing the frequency and sizes of settle-
ments, according to the traditional model.[34] After Part I presents key aspects
of the traditional model, Part II discusses why these are mere half-truths—
points that are true but that yield inaccurate conclusions because they are
merely part of a larger story.

### A. *The Economics of Litigation Settlement:*
*Why Cases Do and Don't Settle*

### 1. *The Basic Economic Model:*
*Why Cases Should (and Usually Do) Settle*

In the economic model of settlement that is based on the parties' mone-
tary costs and benefits, the settlement value is the expected value ("EV") of
the claim, i.e., the probability of a plaintiff's verdict ("p") times the mone-
tary amount of such a verdict ("L"), adjusted for the parties' litigation costs
($C_P$ and $C_D$).[35] The defendant will offer any amount less than the EV of the
claim plus its litigation costs; the plaintiff is willing to accept any amount
more than EV minus its own litigation costs. As long as either party has liti-
gation costs, all cases will settle, because the defendant's maximum offer
will exceed the plaintiff's minimum.[36]

Where:

| | | |
|---|---|---|
| p | = | probability of plaintiff prevailing |
| $L_M$ | = | amount of monetary liability if plaintiff wins |
| $pL_M$ | = | expected value of verdict (probability times amount)[37] |

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32.   *See infra* Section I.A.2. Of course, economic theory does account for other reasons that
cases may not settle, or at least may not settle as early as they should. *See infra* note 51. This Article
focuses on divergent expectations as a reason for not settling simply because that is the reason most
directly impacted by whether or not settlements are confidential.

33.   *See infra* Section I.B.

34.   *See infra* Section I.B.

35.   Grundfest & Huang, *supra* note 28, at 1273 ("[T]he lawsuit's expected value is typically
described as the probability that the plaintiff will prevail multiplied by the likely award."));
POLINSKY, *supra* note 27, at 135–36. For algebraic and numerical examples of this analysis, see
BONE, *supra* note 27, at 73–74, 89–90; POLINSKY, *supra* note 27, at 135–38.

36.   *See* BONE, *supra* note 27, at 75, 89.

37.   More precisely, "[t]he expected value . . . [of] an uncertain situation is a weighted aver-
age of the payoffs or values resulting from all possible outcomes. The probabilities of each outcome
are used as weights." PINDYCK & RUBINFELD, *supra* note 25, at 150. In the above model:

$$EV = \sum_{i=1}^{n} p_i L_i .$$

$C_D$  =   defendant's remaining litigation costs if settlement not reached
$C_P$  =   plaintiff's remaining litigation costs if settlement not reached
$O_D$  =   defendant's reservation price (maximum acceptable offer)[38]
$O_P$  =   plaintiff's reservation price (minimum acceptable offer)[39]

Then:

$O_D$  =   $pL_M + C_D$    (i.e., D offers anything less than expected
                               Liability plus D's litigation costs)
$O_P$  =   $pL_M - C_P$    (i.e., P accepts anything above expected
                               liability minus P's litigation costs)

Thus:

$O_D = O_P + (C_D + C_P)$
$\rightarrow O_D > O_P$    (as long as $(C_D + C_P)$ is a positive number)

Settlement range:      $O \ni [\, pL_M - C_P , pL_M + C_D \,]$
Settlement surplus (width of range):[40]
                       $C_D + C_P$

In sum, due to litigation costs, there is a settlement surplus, an amount between the parties' reservation prices (their "bottom line" offers) that leaves room to negotiate—so long as the parties sufficiently agree on p and L, the likelihood and size of a plaintiff's verdict. As discussed below, disagreement among the parties as to p or L (typically with each party being overconfident), can inhibit settlement—but only to a point.[41]

## 2. The Basic Economic Model with Divergent Beliefs: Why Some Cases Don't Settle Quickly

Parties to lawsuits commonly begin their dispute in a state of "mutual optimism": typically, plaintiffs overestimate the EV of their claims, while defendants underestimate the EV of plaintiffs' claims.[42] "A common feature of human behavior is overoptimism," scholars have noted, including in the litigation context.[43] Certainly, not *all* people are optimists; but people pessimistic about their legal claims are less likely to file lawsuits and, when they do file,

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By way of example: a lawsuit with a 50% chance of a defense verdict (EV=$0), a 40% chance of a $10,000 verdict (EV=$4,000), and a 10% chance of a $50,000 verdict (EV=$5,000) yields a total EV of $9,000. *See, e.g.,* BONE, *supra* note 27, at 23–26 (providing a similar example).

38.    BONE, *supra* note 27, at 74.

39.    *Id.*

40.    The math works out as follows: the width of the settlement range is the plaintiff's reservation price ($O_P$) minus the defendant's reservation price ($O_D$):
$O_P - O_D = (pL_M - C_P) - (pL_M + C_D) = C_P + C_D$

41.    For a brief discussion of other reasons cases may not settle, or at least may not settle as early as they should, see *infra* note 51.

42.    BONE, *supra* note 27, at 85–91.

43.    Christine Jolls, Cass R. Sunstein, & Richard Thaler, *A Behavioral Approach to Law & Economics,* 50 STAN. L. REV. 1471, 1524 (1998).

are more eager to settle quickly. The pool of cases in litigation is dispropor-
tionately populated by litigants optimistic about their legal positions.

Litigant optimism makes cases less likely to settle: litigation costs pro-
vide insufficient incentive to settle if the plaintiff thinks its odds of winning
(p) are 90% while the defendant thinks the odds are 10%, or if plaintiff
thinks defendant's monetary liability ($L_M$) is \$100,000 while defendant
thinks it would be \$10,000.[44] Divergent estimates of p and $L_M$ may prevent
settlement, because the defendant's maximum offer will be less than the
plaintiff's minimum:

Where:
| | | |
|---|---|---|
| $p_p$ | = | plaintiff's estimate of odds of plaintiff prevailing at trial |
| $p_d$ | = | defendant's estimate of odds of plaintiff prevailing at trial |
| $L_{M(p)}$ = | | plaintiff's estimate of odds of plaintiff prevailing at trial |
| $L_{M(d)}$ = | | defendant's estimate of odds of plaintiff prevailing at trial |

Then a settlement surplus exists (i.e., the case still will settle) if:[45]

$O_p < O_D$ (i.e., if D's maximum offer is below P's minimum)

$\rightarrow$ $p_p L_{M(p)} < p_d L_{M(d)} + (C_P + C_D)$

$\rightarrow$ $p_p L_{M(p)} < p_d L_{M(d)} < (C_P + C_D)$

$\rightarrow$ $(EV_p - EV_d) < (C_P + C_D)$          (i.e., if litigation costs exceed the
                                                difference in EVs)

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44.    This model considers divergence in the parties' p estimates, not their L estimates, but
mathematically, the same point would remain if the divergence were in L rather than in p.

Where:    $L_{M(p)}$ = plaintiff's estimate of odds of plaintiff prevailing at trial
          $L_{M(d)}$ = defendant's estimate of odds of plaintiff prevailing at trial

Then a settlement surplus exists (>0) if:

$O_p < O_D$

$\rightarrow$    $pL_{M(p)} - C_P < pL_{M(d)} + C_D$

$\rightarrow$    $L_{M(p)} - L_{M(d)} < (C_P + C_D)/p$

45.    In the special case that only p varies or only $L_M$ varies, the situation is the same, though
with simpler math:

| *(I) Only p Varies:* | | *(II) Only $L_M$ Varies:* |
|---|---|---|
| $O_p < O_D$ | | $O_p < O_D$ |
| $\rightarrow$   $p_p L_M - C_P < p_d L_M + C_D$ | $\rightarrow$ | $pL_{M(p)} - C_P < pL_{M(d)} + C_D$ |
| $\rightarrow$   $p_p L_M - p_d L_M < C_P + C_D$ | $\rightarrow$ | $pL_{M(p)} - C_P < pL_{M(d)} + C_D$ |
| $\rightarrow$   $(EV_p - EV_d) < (C_P + C_D)$ | $\rightarrow$ | $(EV_p - EV_d) < (C_P + C_D)$ |
| | | (same as in main text above) |

If the parties diverge as to only one of p or $L_M$, we can specify the conditions for settlement with a
bit more particularity, however:

$p_p L_M - p_d L_M < C_P + C_D$                    $pL_{M(p)} - C_P < pL_{M(d)} + C_D$
                                                  (Second to last equation just above)
$\rightarrow$   $(p_p - p_d) < (C_P + C_D)/L_M$      $\rightarrow$   $L_{M(p)} - L_{M(d)} < (C_P + C_D)/p$

In (I), where only p varies, the condition for settlement is that the divergence in p is not larger
than the litigation costs as a fraction of the monetary liability. In (II), where only $L_M$ varies, the
condition for settlement is that the divergence in $L_M$ is not larger than the litigation costs divided by
the probability of a plaintiff's victory.

The last expression above illustrates that even with mutual optimism, a case still should settle as long as the difference in expectations is not greater than the parties' total litigation costs. If the difference in expectations is large enough (and litigation costs not correspondingly large), however, the case will not settle.

Importantly, even if the parties' views are divergent enough to prevent early settlement, a later settlement remains likely—as the data on high settlement rates confirm.[46] Optimism is easy for parties to maintain when each side lacks key information on the other side's evidence and arguments, which is typical early in litigation; before the parties get too far in litigation, each is unlikely to recognize its own weaknesses and its opponents' strengths.[47] This information asymmetry is why the plaintiff can believe that p is high while the defendant can believe that p is low in the same case—a divergence that makes the parties less willing to compromise to save litigation costs.[48] Over the course of litigation, however, the parties exchange evidence and challenge each other in discovery and pretrial motions (e.g., discovery motions or dismissal motions), which tends to deflate the self-servingly optimistic views of both: the plaintiff's estimate of p falls ("Wait, there's actually a chance I could lose?!") while the defendant's estimate of p rises ("Wait, there's actually a chance he could win?!").[49]

In economic terms, lawsuits begin with imperfect and asymmetric information; pretrial practice is the process of information exchange that increases, and equalizes, the parties' information. As Robert Bone explains, "[a]s the lawsuit progresses . . . through discovery[,] . . . [a]t some point . . . the parties['] estimates are likely to converge sufficiently to create a settlement range and a positive settlement surplus . . . ."[50] This economic insight explains why the vast majority of cases do settle, but do not all settle *early* in the parties' dispute.[51]

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46. *See* Frank E.A. Sander & Lukasz Rozdeiczer, *Matching Cases and Dispute Resolution Procedures: Detailed Analysis Leading to a Mediation-Centered Approach*, 11 HARV. NEGOT. L. REV. 1, 40 (2006) ("According to data from the federal courts, ninety-eight percent of all civil cases and ninety-five percent of criminal cases settle through agreement of the parties or are withdrawn from the court without a final court decision.").

47. *See* COOTER & ULEN, *supra* note 27, at 407 ("[T]he defendant knows less than the plaintiff about the extent of the injury, and the plaintiff knows less than the defendant about the extent of the defendant's precautions . . . .").

48. BONE, *supra* note 27, at 85–91. L also could vary, to the same effect.

49. Of course, as a case progresses, the parties' monetary incentive to settle (saving litigation costs) decreases because fewer litigation costs remain. But litigation costs accumulate at a more gradual pace (i.e., a few hundred dollars for every hour of attorney effort), whereas discovery can turn a nonsettling case into a settlement in short order because a major discovery event can abruptly change the parties' estimates of p. For example, the plaintiff's claim may fall apart after a major admission in a deposition, or the defendant may get scared after the plaintiff finds a key document.

50. BONE, *supra* note 27, at 90–91; *see also* Tom Ginsburg & Glenn Hoetker, *The Unreluctant Litigant? An Empirical Analysis of Japan's Turn to Litigation*, 35 J. LEGAL STUD. 31, 34 (2006) ("Litigation occurs only when parties either cannot or do not predict what the court will do. If courts are predictable and the result can be accurately determined in advance, rational parties will settle.").

51. Of course, there are other reasons parties do not settle. For example, emotions like revenge or passion can counteract monetary incentives to settle, in which case a plaintiff's L would

## B. *The Basic Economic Model with Confidentiality: Confidentiality Increases the Settlement Range Because It Is Valuable to Defendants*

Settlement confidentiality increases defendants' willingness to settle because the liability costs of lawsuits, to defendants, go beyond just monetary liability. Part of the liability (L) to defendants is reputational cost ($L_R$), the cost of undesirable public knowledge of a verdict or settlement it pays. Reputational costs include more than one kind of harm to defendants. One is the risk that a public settlement will give the defendant "a reputation for settling," which might "encourage rogue plaintiffs with meritless claims to attempt to extract settlement[s],"[52] as Richard Posner[53] and Richard Epstein[54] argue. Another type of reputational cost is loss of goodwill: laws mandating more disclosure can "raise [a] corporation's 'embarrassment cost,' ... to a prohibitively high level"[55] by deterring "potential" customers or investors;[56] or, as Abraham Lincoln more pungently observed, "what kills a skunk is the publicity it gives itself."[57] For present purposes, it does not matter in which sense a publicly disclosed settlement hurts a defendant's reputation, whether giving it a bad name in the community or giving it a reputation as an "easy mark" for plaintiffs. Either way, public settlements impose costs beyond the money defendants pay.

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exceed $L_M$, because L would include money *plus* the emotional value of a verdict. *See* Peter H. Huang & Ho-Mou Wu, *Emotional Responses in Litigation*, 12 INT'L REV. L. & ECON. 31, 32 (1992). Settlement also may be delayed by hard bargaining or psychological biases such as anchoring effects (e.g., sticking to now obsolete initial offers) and endowment and status quo effects that dissuade parties from deals that change their positions. *See* Russell Korobkin & Chris Guthrie, *Heuristics and Biases at the Bargaining Table*, 87 MARQ. L. REV. 795, 797 (2004).

52.    Lothes, *supra* note 26, at 456–57 ("[I]f the defendant establishes a reputation for settling, she may encourage rogue plaintiffs with meritless claims to attempt to extract settlement .... [O]penness provides fodder for nuisance suits ...."); *see also* BONE, *supra* note 27, at 66; POSNER, *supra* note 27, at 570; David Rosenberg & Steven Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3, 6 (1985).

53.    POSNER, *supra* note 27, at 570.

54.    Epstein postulates "mandatory disclosure would likely have the effect of increasing dubious as well as sound litigation." He explains as follows:

> [I]nformation obtained by one plaintiff will become readily available to others. This will reduce the cost of filing lawsuits, and increase the number of "follow-on" suits. The publication of settlement figures, even in cases where the defendant has fought the case very hard, will likewise encourage more plaintiffs to file suit against the defendant.

Richard A. Epstein, *The disclosure dilemma: Why a ban on secret legal settlements does more harm than good*, BOSTON GLOBE, Nov. 3, 2002, at D1.

55.    John C. Coffee, Jr., *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099, 1251 (1977) (critiquing disclosure requirements in federal securities laws).

56.    *See id.* at 1255–56.

57.    THE WORDSWORTH DICTIONARY OF QUOTATIONS 237 (Connie Robertson, ed., 2001).

Given that the predominant "secrecy versus publicity" preference is defendants' preference for secrecy,[58] the presence of $L_R$ widens the settlement range, which now exists because of not only litigation costs, but also the reputational cost a defendant suffers from a plaintiff's verdict, which makes L higher for defendants than for plaintiffs. This difference in L widens the settlement range when the defendant can eliminate the reputational cost by reaching a *confidential* settlement. Formally, the defendant's reservation price ($O_D$), or maximum offer, rises by $pL_R$, from $pL_M$ to $p(L_M+L_R)$, which increases the settlement surplus (i.e., widens the settlement range):

Where:

$\quad$ $L = L_M + L_R$ $\qquad\qquad$ (i.e., D's liability is both monetary & reputational)

Then:

$\quad$ $O_P$ $\;= pL_M - C_P$ $\qquad\qquad$ (same as in the Section II.A models with no $L_R$)

$\rightarrow$ $\quad$ $O_D$ $\;= p(L_M+L_R) + C_D$ $\quad$ (higher than in Section II.A: L rises from $L_M$ to $L_M+L_R$)

$\quad$ Settlement range: $\qquad\qquad$ $O \ni [\, pL_M - C_P \,,\, p(L_M+L_R) + C_D \,]$

$\quad$ Settlement surplus: $\qquad\qquad$ $C_D + C_P + pL_R$

$\quad$ Increase in surplus: $\qquad\qquad$ $pL_R$ (surplus "increases" compared to the Section II.A models)

Thus, when a verdict or public settlement imposes reputational costs, the amount a defendant will pay for a *confidential* settlement exceeds what it would pay for a non-confidential settlement that would not eliminate $L_R$. This is the traditional economic argument for allowing confidentiality; as Posner explains,

> "keep[ing] the terms of the settlement secret . . . becomes an inducement to defendants to settle large cases to avoid a public judgment . . . . Ordinarily

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58. Admittedly, parties' confidentiality preferences vary; while most defendants want secrecy, there are three other possibilities—but they are of little significance to this Article's analyses:

(1) *Plaintiffs may value confidentiality too*—but for two reasons, plaintiffs on average will not value confidentiality as much as defendants. First, plaintiffs do not share defendants' concern about publicity spurring copycat lawsuits. Second, the most confidentiality-minded plaintiffs can opt out of litigation (i.e., not file suit if they badly fear disclosure of harmful information), but the most confidentiality-minded defendants cannot opt out of being sued.

(2) *Plaintiffs may value publicity.* A plaintiff may want a public verdict to obtain justice and vindication, but (1) many lawsuits are just about the money, and (2) even if some plaintiffs value publicity, the fact that most settlements are confidential indicates that the "premium" defendants offer for secrecy is enough to overcome most plaintiffs' desire for publicity.

(3) *Defendants may value publicity, not confidentiality.* A defendant may think it has a good chance of deterring future lawsuits by winning a defense verdict. But those situations likely are infrequent; defense verdicts do not get public attention ("Plaintiff Loses Lawsuit" is not a common headline) unless the lawsuit is novel in some way.

Thus, the predominant secrecy/publicity preference is defendants' desire for secrecy, which is why most scholars have focused on that preference rather than on the above three other possibilities.

the plaintiff will be happy to agree to such a confidentiality provision be-
cause it will enable a quicker and larger settlement."[59]

Conversely, a *ban* on confidential settlements decreases settlement by
eliminating this widening of the settlement range. In some cases at the mar-
gins of being "settlable," the parties could reach a settlement if
confidentiality were on the table but could not do so without confidentiality
available; the plaintiff's ability to sell silence makes the difference in con-
vincing the defendant to offer enough for the plaintiff to accept. The loss to
the settlement surplus is $pL_R$ (as explained immediately above), so that loss
is greatest when p and $L_R$ are high, i.e.:

(1) when the claim is meritorious, i.e., when p is high;

(2) when the alleged injury is substantial, i.e., when $L_R$ is high, which will
    tend to be when $L_M$ is high (i.e., more bad press from a high-level injury
    and damages award); and

(3) when the defendant is more reputation-sensitive (e.g., more dependent
    on customer goodwill or more fearful of similar future lawsuits).

Points (1) and (2) in particular show a troubling repercussion of banning
confidentiality: a ban would inhibit settlement most when claims are most
worthy, that is, when the plaintiff actually suffered a substantial injury (high
L) for which the defendant likely is liable (high P). Without confidentiality,
the worthy plaintiff is less likely to obtain an acceptable settlement, and a
defendant facing serious risk of liability is less likely to make that plaintiff
an acceptable offer.

This is a bleak cautionary tale of a no-confidentiality regime, but it is
only part of the story—the ugly part, yet the most widely noted part. Part II
discusses several positive features (and some ambiguous aspects) of a no-
confidentiality regime, brightening the prospects of a world without confi-
dentiality.

## II. A New Economic Analysis of Confidential Settlements: Accelerating Settlement, Decreasing Frivolous Litigation, and Other Unintuitive Effects of Banning Confidentiality

The traditional model's depiction of confidential settlements contains a
great deal of truth but is so incomplete that it ultimately misleads more than
it explains. Yes, banning confidentiality would decrease defendants' incen-
tive to make higher settlement offers during litigation, because settlements

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59.   POSNER, *supra* note 27, at 570; *see also* Shavell, *supra* note 26, at 605 (1997) ("'[S]ecrecy
. . . helps to explain why [parties] settle . . . . [A] firm whose product was defective may not want
this information to come to public light and . . . the victim may not much care whether the informa-
tion is revealed."); Epstein, *supra* note 54 ("[M]andatory settlement disclosure may make it harder
for individual plaintiffs to get justice in a timely manner. Defendants who fear follow-on litigation
will likely seek to postpone settlement . . . to prevent the details of the case from becoming known
. . . [and] resist[ ] . . . discovery.").

would no longer save them from all reputational costs. But there is much more to the story.

Section II.A illustrates how banning settlement confidentiality actually may *promote* settlements. As Section II.A explains, a confidentiality ban could not cover settlements reached *before* litigation commences, so it could deter only *postfiling* settlements. Consequently, a ban would encourage settlements *prefiling*, when parties still could obtain confidentiality. It is hard to measure these competing effects, but a shift to more prefiling but fewer postfiling settlements seems promising because earlier settlements save more litigation costs.

Section II.B notes another critical distinction that the traditional model neglects: the effects of a confidentiality ban will differ for high-value and low-value cases. Some defendants may fear publicity from *one big* public settlement more than that from *several small* settlements, but the reverse may be true for others. Section II.B discusses how the effects of confidentiality would vary among high- and low-value cases, depending mainly on whether defendants more greatly fear disclosure of a few large settlements or disclosure of many small settlements. However, because defendants vary as to their confidentiality preferences (because, for example, they vary in how disclosed settlements would be viewed by customers or business partners), we cannot predict whether banning confidentiality would affect high- or low-value cases more overall. This is a note of caution that certain effects of banning confidentiality may be quite unpredictable, contrary to the traditional model's assertion that banning confidentiality would spur more low-value frivolous suits.

Section II.C notes that banning confidentiality, by increasing public disclosure of settlements, would improve the efficiency of litigation and settlement decisions. With better information about the value of similar legal claims, parties to litigation would know more about whether to settle and for how much. Similarly, requiring settlement disclosure would decrease litigation uncertainty, and, as shown by recent economic scholarship modeling litigation as "real options,"[60] decreasing litigation uncertainty likely deters frivolous claims.

Section II.D notes a non-litigation benefit of increased settlement disclosure: better decision-making by *market participants*, such as employees making job decisions or consumers and investors making buying decisions. With more information about which companies pay what in lawsuits, employees, consumers, and investors could make better-informed decisions. Currently, there is little good public information about which jobs or products are the ones to avoid, so people rationally but excessively avoid ones that *might* be hazardous—e.g., avoiding jobs in an entire industry in which some employers allow harassment, or avoiding an entire product line because of some hazardous items. Such over-avoidance can lead people to choose worse off-market alternatives. More information about who are (or

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60.    Grundfest & Huang, *supra* note 28.

are not) the "bad apples" paying significant liability costs would mitigate this problem of uncertainty inducing inefficient choices.

As a whole, Part II illustrates that even though a confidentiality ban would decrease postfiling settlements, (1) there would be an offsetting increase in prefiling settlements; (2) even if the total number of settlements decreased, total litigation costs might decrease because prefiling settlements save more litigation costs; and (3) even if a ban did not lead to more settlement efficiency, it still might have efficient dynamic effects such as discouraging frivolous lawsuits and improving labor and consumer market efficiency. Thus, while we must be cautious about predicting the net effects of a confidentiality ban, there is reason to think that, contrary to the conventional wisdom of the existing economic literature, the benefits of a confidentiality ban would be real and many.

In short, while the traditional economic model views a ban on confidentiality as an inefficient anti-market proscription that prevents parties from transacting as to something of value (i.e., concealment of information harmful to defendants), Part II shows the reality to be more nuanced and complex. Given the wide array of competing effects, it is impossible to predict the net effect of banning confidentiality. The most we can say is that a confidentiality ban would be a promising but uncertain experiment—a nuanced conclusion that stands in stark contrast to the simplistic "pro-confidentiality" conventional economic wisdom.

## A. *Prefiling vs. Postfiling Settlements: Settlements Occurring Earlier Because Confidentiality Will Remain Available Only for Prefiling Settlements*

### 1. *The Inability of a Confidentiality Ban to Reach Prefiling Settlements Effectively*

#### a. *The Ease of Enforced Disclosure of Postfiling Settlements; the Difficulty of Enforced Disclosure of Prefiling Settlements*

A ban on confidential settlements of cases in litigation would be easy to implement and enforce: either legislation or a simple committee of judges could amend Federal Rule of Civil Procedure 41. Rule 41 currently allows parties the unfettered right to dismiss their cases upon reaching a settlement; all that is necessary to ban confidentiality is for Rule 41 to state that the court-filed dismissal stipulation must attach a copy of the parties' settlement agreement. This would be analogous to existing federal court rules requiring

disclosure into the court record of class action settlements[61] and plea bargain agreements (essentially "settlements" of criminal cases).[62]

In contrast, no ban on confidential settlements can expect to reach all *prefiling* settlements—settlements of disputes not yet filed in court. Parties commonly settle employment disputes, for example, by agreeing that the employee will leave the employer in exchange for a severance agreement that (typical of severance agreements) includes a waiver of any workplace claims the employee might have.[63] Such settlements are basically indistinguishable from typical severance offers made to departing employees not embroiled in any workplace dispute; even when no lawsuit has been threatened, employers making severance offers typically demand that departing employees, in exchange for their severance, sign a release of any legal claims whatsoever.[64] Similarly, in a customer-manufacturer dispute over a defective product, a prefiling settlement is the same as a simple agreement by the manufacturer to reimburse the purchaser's losses, such as the cost of a replacement (which may be substantial for an expensive product like a car or a home furnace) and the cost of any injuries resulting from the defect (e.g., medical expenses). In short, a prelitigation settlement is just a contractual agreement by two parties that is never seen by anyone else; it flies well below the radar of any court or agency that might have jurisdiction over a ban on confidential settlements.

Thus, even if a ban on confidential settlements is enacted and the legal system enters a "no-confidentiality regime," that ban could expect to cover only *postfiling* settlements; it could not reliably prevent confidentiality of *prefiling* settlements.

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61.    FED. R. CIV. P. 23(e) (requiring disclosure to court and all class members of proposed settlement agreements).

62.    FED. R. CRIM. P. 11(c)(2) ("Disclosing a Plea Agreement. The parties must disclose the plea agreement in open court when the plea is offered, unless the court for good cause allows the parties to disclose the plea agreement in camera."); *id.* 11(c)(4) ("If the court accepts the plea agreement . . . the agreed disposition will be included in the judgment.").

63.    Attempting pre-litigation settlement is standard practice for plaintiffs' lawyers, who try to negotiate to avoid having their clients, employees with legal claims against their employers, ever become "plaintiffs." *See, e.g.*, Wayne N. Outten et al., *Overview of Workplace Claims in New York: Perspective of Employees' Counsel*, 662 PRAC. L. INST. (LITIG.) 1179, 1183 (2001) (advising fellow plaintiffs' employment lawyers to "try every possible avenue to resolve the dispute without . . . formal litigation[,]" beginning with pre-lawsuit settlement talks and then "escalat[ing] confrontation incrementally").

64.    *See, e.g.*, Patricia Costello Slovak, *Labor and Employment Law Issues in the Acquiring or Selling of a Privately Held Company, in* ACQUIRING OR SELLING THE PRIVATELY HELD COMPANY 2003, at 883, 888 (PLI Corp. L. & Practice, Course Handbook Series No. 1375, 2003) (encouraging downsizing companies to offer "early retirement incentive plans . . . [with] enhanced severance or retirement benefits . . . in exchange for a release of employment-related claims").

b. *Creative Efforts to Reach Prefiling Confidentiality:*
*Limited Prospects for Success*

Conceivably, a ban on confidential settlements could *try* to reach prefiling settlements in one of three ways—but none would be truly effective, at least not nearly to the same extent as a ban on postfiling settlements.

First, courts could declare that confidentiality clauses in even private (i.e., not court-filed) settlement agreements are unenforceable, so that plaintiffs who promise confidentiality would remain free to blab without repercussions. Such prefiling settlements still would be much less likely to become truly "public" than postfiling settlements required to be filed in court, however. Postfiling settlements would be public documents available to online or physical searches by law firms, academics, or the media. Because settlement data would be quite valuable, it would very likely be compiled in "settlement reporters" analogous to the litany of "jury verdict reporters" on the market today.[65] It is hard to see how very many prefiling settlements would become so publicly available: most plaintiffs lack the sophistication to know whom to alert, those researching settlements would not know where to find parties who settle clandestinely, and the mainstream media would not often be interested enough in run-of-the-mill settlements to cover them.[66]

Second, the defendant could insist that the plaintiff enter an oral, under-the-table "side deal" for secrecy, even if such secrecy clauses are banned. Of course, plaintiffs could breach those illegal "side deals" without legal consequence, but defendants could create incentives for plaintiffs to comply. Unlike plaintiffs, plaintiffs' *lawyers* are repeat players in the legal system, so they have an incentive to prevail upon their clients to keep quiet: if *this plaintiff* keeps quiet, then the defendant will trust *this plaintiff's lawyer* to keep *future clients* quiet, so this plaintiff's lawyer could get more money out of that defendant in future settlements. Additionally, defendants could insist on partially deferred settlement payouts, perhaps spacing the payouts over a year or two; if the plaintiff breaches the illegal "secrecy side deal," then the defendant couldn't *legally* withhold the extra funds, but it might do so anyway, because any effort by the plaintiff to sue for unpaid settlement proceeds likely would not be 100% successful.[67] Finally, in some cases, defendants will have embarrassing information about the plaintiff, such as medical evidence or information about the plaintiff's shortcomings as an

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65. See, for example, Jury Verdict Summaries from the National Association of State Jury Verdict Publishers, http://www.juryverdicts.com (last visited Nov. 24, 2006).

66. While settlement data is newsworthy in the aggregate, most settlements are not newsworthy individually; "Smith Barney's Discrimination Settlements Exceed Industry Average" is a headline, but "Smith Barney Pays Plaintiff X $20,000" is not.

67. Two key limitations on a plaintiff's ability to collect settlement proceeds in a lawsuit are (1) that a plaintiff who had agreed to secrecy might well lose under the "unclean hands" doctrine and (2) that even the strongest debt-collection claim settles for less than 100 cents on the dollar (in part because, as Section I.A explains, litigation costs induce parties, including plaintiffs in entirely meritorious suits, to compromise).

employee. The defendant could easily threaten the plaintiff by saying that if the plaintiff disclosed the settlement, the defendant would disclose any information it had about the plaintiff. The information would not have to be incredibly personally embarrassing; a simple recitation of a plaintiff's on-the-job failings, for example, could harm her re-employment prospects. Thus, in various ways, a defendant could penalize a plaintiff to some degree for violating a secrecy side deal.

Third, courts could declare that if a settlement has a confidentiality clause, then the plaintiff's waiver of her claim is invalid, and the plaintiff can sue despite reaching the "settlement."[68] This would be a drastic step, but even this would have little practical effect for one critical reason. In a lawsuit following a confidential settlement, even if the plaintiff won at trial, the damages award would likely be reduced by the amount he or she already received in the (invalid) confidential settlement. That is the weight of authority under the one major statute declaring certain kinds of settlements invalid, the Older Workers Benefits Protection Act ("OWBPA"). The OWBPA imposes strict requirements on waivers of federal age discrimination claims and declares invalid any waivers of claims contained in noncompliant settlements.[69] Where a plaintiff sues after agreeing to a settlement in which the waiver of claims violated the OWBPA, courts typically reduce any eventual damages award by the amount of money received in the settlement.[70]

The sort of "damages offset" applicable in OWBPA cases would apply with even *more* force in the context of a ban on confidential settlements. After all, a plaintiff who signs a waiver lacking the worker-protective OWBPA requirements typically was not herself complicit in the violation;[71] courts do not begrudge the plaintiff her later lawsuit, because it was the

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68.    Dana & Koniak, *supra* note 26, at 1219 (arguing that confidential settlements should be "null and void," civilly "actionable," and subject to "mandatory sanctions" for the participating attorneys, and even "punishable" under criminal law); Daughety & Reinganum, *Secrecy and Safety*, *supra* note 23, at 1087 ("In order to truly eliminate confidentiality, courts . . . would have to refuse to enforce private contracts of silence. Otherwise, confidential settlements would simply be pushed into this area of contracts, where they would be subject to even less judicial oversight.").

69.    29 U.S.C. § 626(f) (2000).

70.    *See, e.g.*, Blackwell v. Cole Taylor Bank, No. 96-C-0902, 1997 WL 156483, at *3 (N.D. Ill. Mar. 31, 1997) (holding that, where plaintiff sued after signing an invalid waiver under OWBPA, the appropriate damages rule was "reducing the amount of any recovery . . . by the amount of the consideration received for the waiver"); Rangel v. El Paso Natural Gas Co., 996 F. Supp. 1093, 1099 (D.N.M. 1998) (following *Blackwell*); *cf.* 29 C.F.R. § 1625.23(c)(1) (2006) ("[C]ourts have the discretion to determine whether an employer is entitled to restitution, recoupment or setoff . . . against the employee's monetary award."); Cole v. Gaming Entm't, 199 F. Supp. 2d 208, 216 (D. Del. 2002) ( "[I]f [plaintiff] is successful . . . it may be appropriate to reduce any monetary recovery by the amount . . . received for the waiver."). *But see* Kulling v. Grinders for Indus., 185 F. Supp. 2d 800, 814–15 (E.D. Mich. 2002) (finding no requirement that Age Discrimination in Employment Act plaintiff's damages be set off by the plaintiff's severance partially because plaintiff's waiver was invalid only as to his ADEA claims but valid for other claims that remained waived).

71.    The OWBPA essentially requires various procedures and disclosure requirements of *employers* to benefit older workers. *See generally* Eric A. Taussig, *The Older Workers Benefit Protection Act*, 410 PRAC. L. INST. (LITIG.) 235 (1991) (summarizing OWBPA's purposes and requirements).

*defendant* who violated the OWBPA and must suffer the consequences of an invalid waiver. In contrast, under a no-confidentiality regime, a plaintiff who signs an illegally confidential settlement is entirely complicit in the illegality and would have benefited from it, by inducing the defendant to pay "hush money" in the settlement.[72] It is hard to see how an innocent OWBPA plaintiff could suffer a damages setoff while a non-innocent confidential settlement plaintiff would not.[73]

Thus, even if a confidentiality ban went so far as to declare that a plaintiff could still sue after getting paid in an illegally confidential settlement, the plaintiff's incentive to sue would be markedly lower, because her damages likely (at least probabilistically) would be reduced by the amount already received in the settlement. Similarly, as discussed above, even if plaintiffs who settled were allowed to breach their confidentiality promises, prefiling settlements would be much more likely to remain hidden than postfiling settlements. For this reason, even in a no-confidentiality regime, prelawsuit confidential settlements would remain effective; a defendant settling prefiling cannot be *sure* the settlement will remain out of public view, but that defendant certainly has a much better *chance* of keeping it out of public view when it settles prefiling.

### 2. *The Beneficial Aspect of a Confidentiality Ban Being Limited to Postfiling Settlements*

#### a. *Incentive to Accelerate Settlement*

Although this "pre versus post" distinction is a critical one, it has gone unanalyzed by virtually the entire literature on confidential settlements. A recent short symposium piece by Christopher Drahozal and Laura Hines does note the distinction briefly, observing that if confidentiality were banned, parties could "readily avoid" that ban with a prefiling settlement.[74] Drahozal and Hines, however, do not analyze why a ban could not reach prefiling settlements effectively, as discussed above; neither do they note

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72.   *See supra* note 59 and accompanying text (noting how not only defendants, but also plaintiffs, have an incentive to contract for secrecy).

73.   Further, it is possible that courts would be constitutionally required to impose a damages setoff. If a court allowed a plaintiff to recover a verdict of full compensatory damages after a settlement of at least partial compensation for the same loss, it would be awarding damages above the amount necessary to compensate, so the damages award would be punitive in nature. The Supreme Court several times recently has limited plaintiffs' ability to recover punitive damages. *See* BMW of N. Am. v. Gore, 517 U.S. 559, 575–85 (1996) (applying multi-factor test to reject punitive damages award under substantive due process); State Farm Mut. Auto. Ins. v. Campbell, 538 U.S. 408, 429 (2003) (holding same, establishing rigor of *Gore* test); Cooper Indus. v. Leatherman Tool Group, 532 U.S. 424, 436 (2001) (holding that review is *de novo* of jury's punitive damages award); Kolstad v. Am. Dental Ass'n, 527 U.S. 526, 545 (1999) (establishing affirmative defense to punitive damages liability).

A full examination of this constitutional issue is beyond the scope of this Article (and perhaps worthy of its own article). It suffices here to note that constitutional considerations make it all the more likely that courts would set off damages by the amount of a prior settlement.

74.   Drahozal & Hines, *supra* note 17, at 127.

that even if a ban encourages prefiling settlements, that is not necessarily undesirable "circumvention." Even if a confidentiality ban *could* reach prefiling settlements, moreover, it may be more desirable to limit the ban to postfiling settlements, as discussed below.[75]

With a ban covering only postfiling settlements, prefiling settlements could still be confidential and thereby save the defendant reputational costs $(L_R)$. Indeed, a settlement *immediately* prefiling is a defendant's last chance to settle *before liability rises* from $L_M$ to $(L_M + L_R)$. Consequently, in a no-confidentiality regime, the presence of reputational costs creates a critical difference between pre- and postfiling settlements. Because only a prefiling settlement saves the defendant reputational costs (i.e., saves the defendant from having liability increase after filing from $L_M$ to $L_M + L_R$), a no-confidentiality regime incentivizes defendants to be more generous with prefiling settlements:

Defendant's maximum offer: $\quad\quad\quad\quad\quad\quad\quad\quad$ $O_D = pL + C_D$
$\quad$ Prefiling (with confidentiality): $\quad\quad\quad\quad$ $O_D = p(L_M + L_R) + C_D$
$\quad\quad$ Settlement range: $\quad\quad\quad\quad\quad\quad\quad$ $O_D \ni [pL_M - C_P, p(L_M + L_R) + C_D]$
$\quad\quad$ Settlement surplus (width of range): $\quad$ $C_P + C_D + pL_R$
$\quad$ Postfiling (without confidentiality): $\quad\quad$ $O_D = pL_M + C_D$
$\quad\quad$ Settlement range: $\quad\quad\quad\quad\quad\quad\quad$ $O \ni [pL_M - C_P, pL_M + C_D]$
$\quad\quad$ Settlement surplus (width of range): $\quad$ $C_P + C_D$

Thus, banning confidentiality would appear to *accelerate* settlement, both because increasing public information facilitates negotiations[76] and because defendants would be more generous with prefiling settlements than with postfiling settlements. Plaintiffs, knowing of this latter effect, would be more likely to accept defendants' prefiling offers.[77] With only postfiling confidentiality banned, the parties would make a serious settlement push immediately prefiling, because that would be their last chance to settle before losing part of the settlement value, plaintiff's ability to "sell confidentiality" to the defendant.

Interestingly, while banning confidentiality seems likely to accelerate settlement, a leading advocate of allowing confidentiality has said exactly the opposite, though without any real analysis of parties' incentives. In a frequently cited article,[78] Arthur Miller criticized proposed restrictions on

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75.  *See infra* Section II.A.2.b.

76.  *See infra* Section II.C.

77.  Indeed, one of the key modeling improvements that game theory brought to economics is that a party's decision can depend on its prediction of the consequences of its opponent's response. Specifically relevant to present purposes: a party's decision regarding what to offer (or accept) in a bargaining situation can depend on its knowledge that the total surplus to be divided—the proverbial "size of the pie"—will decrease imminently, if no deal is reached in the present round of negotiations. *See* Ariel Rubinstein, *Perfect Equilibrium in a Bargaining Model*, 50 ECONOMETRICA 97, 98–99 (1982) (modeling parties' offer/acceptance strategies in "declining pie" negotiation game); ROBERT GIBBONS, GAME THEORY FOR APPLIED ECONOMISTS 68–71 (1992) (same).

78.  Miller, *supra* note 20. A Westlaw KeyCite for 105 HVLR 427 showed 267 citations to this article, including 55 judicial or administrative decisions, 132 secondary sources, and 80 court filings.

settlement confidentiality, opining that their effects would include "reducing the frequency of settlement or *delaying the stage in the litigation at which settlement is achieved.*"[79] Other commentators have cited this "delaying the stage" language from Miller[80] or opined similarly that requiring more disclosure would delay settlement.[81]

This Article's analysis, however, yields a conclusion contrary to Miller's: banning confidentiality would *accelerate*, not delay, the stage at which many settlements occur—but the extent of this effect should not be exaggerated. As discussed above, a postfiling-only confidentiality ban would lead to better early offers from defendants and therefore more prefiling confidential settlements. Availability of prefiling confidentiality would undercut some of the disclosure benefits of a ban, but not *all* of the benefits, for two reasons. First, to alert the public to certain hazards, it is not necessary to disclose *all* settlements, just to disclose enough for word to reach public agencies, consumer advocates, and lawyers considering investigating the hazards in question. Second, even if defendants are incentivized to offer prefiling settlements, not *all* cases can settle before filing. It is hard for a defendant to distinguish good from bad cases so early in a dispute, before the parties exchange information in discovery and test each other's positions with dueling motions. After all, pre-trial litigation is the basic process that normally leads to settlement by both distinguishing good from bad and causing the parties' expectations to converge. Before filing, if defendants cannot tell which cases merit large versus small settlement offers (and therefore must make similar offers to varied plaintiffs), this "pooling" of strong and weak cases[82] prevents defendants from settling as much as they would like: "strong case" plaintiffs would not accept small prefiling offers, and defendants could not afford to offer all plaintiffs, strong and weak alike, enough to satisfy the "strong" ones. Thus, even defendants strongly desiring confidentiality cannot count on being able to settle prefiling; certainly more cases will settle prefiling at the margins, but the increased incentive to settle early cannot overcome all the traditional reasons that not all cases can settle early.

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79.  *Id.* at 486 (emphasis added).

80.  *E.g.*, Alan E. Garfield, *Promises of Silence: Contract Law and Freedom of Speech*, 83 CORNELL L. REV. 261, 333 n.363 (1998) (quoting Miller's language on delaying settlement).

81.  *E.g.*, Richard P. Campbell, *The Protective Order in Products Liability Litigation: Safeguard or Misnomer?*, 31 B.C. L. REV. 771, 835 (1990) ("When parties can no longer rely upon protective orders as a tool to facilitate full and complete disclosure of relevant confidential information, the settlement of cases will be delayed or prevented . . . .").

82.  BONE, *supra* note 27, at 59–60 (defining "pooling" and applying it to the problem of frivolous lawsuits: "If the defendant could distinguish the two types, he would treat meritorious plaintiffs . . . better than frivolous plaintiffs . . . by offering a high settlement to the meritorious . . . .").

### b. *Litigation Cost Savings from Accelerated Settlement*

Having more prefiling settlements would yield a key benefit, an unintended positive consequence of a ban's inability to reach prefiling settlements: early settlements save more litigation costs than later settlements. This militates in favor of a policy that (like a confidentiality ban) encourages earlier settlement. Prefiling settlements actually save *all* litigation costs[83] $(C_P+C_D)$ whereas a postfiling settlement saves only some fraction (r) of litigation costs, i.e., $r(C_P+C_D)$. Thus, the beneficial economic effect of a non-confidentiality regime (encouraging earlier, prefiling settlements) dominates its negative economic effect (discouraging postfiling settlements) so long as:

$$S_{pre} > r*S_{post}$$

Where:

$S_{pre}$ = number of prefiling settlements induced by a non-confidentiality regime

$S_{post}$ = number postfiling settlements deterred by a non-confidentiality regime

r = average percent of litigation costs left when postfiling settlements occur

For example, assume that $r=\frac{1}{3}$ (i.e., the average postfiling settlement occurs when only one-third of litigation costs remain to be spent).[84] In that case, non-confidentiality would increase the litigation cost savings of settlements, so long as the number of prefiling settlements that non-confidentiality encourages is more than one-third the number of postfiling settlements it deters.[85] In short, a prefiling settlement saves more than a postfiling settlement in a given case, so to achieve a net savings of litigation costs, a non-confidentiality regime need not induce as many prefiling settlements as the number of postfiling settlements it deters.

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83. In reality, parties typically incur *some* legal fees before formal litigation, e.g., pre-litigation administrative filings and negotiations. *See* Outten et al., *supra* note 63 (detailing pre-litigation legal efforts). The fact remains, however, that by far the largest share of costs comes in actual litigation.

84. There is reason to think that postfiling settlements occur after the parties already have spent a good deal of their litigation costs. *After* the end of pretrial discovery is a typical point at which cases settle, according to both plaintiff- and defense-side attorneys. *E.g.*, Robert Haig, *Corporate Counsel's Guide: Legal Development Report on Cost-Effective Management of Corporate Litigation*, 610 PRAC. L. INST. (LITIG.) 177 (1999) (defendant-side attorney so noting); William S. Lerach, *Private Securities Litigation Reform Act 1995—1½ Years Later*, 1005 PRAC. L. INST. (CORP.). 569 (1997) (plaintiff-side attorney so noting). According to one major study, the discovery process (which comes after the parties spend time on pleadings and any dismissal motions) takes up about half of litigation costs. THOMAS E. WILLGING ET AL., DISCOVERY AND DISCLOSURE PRACTICE, PROBLEMS, AND PROPOSALS FOR CHANGE 15 (1997). Thus, typically parties will have spent more than half their litigation costs by the time they reach a pretrial but post-discovery settlement.

85. This example assumes that settling cases would entail, if they had not settled, litigation costs similar to those of the cases that do not settle. If settling cases typically are the sort that would have entailed lower litigation costs, then confidentiality would save litigation costs only if it encourages somewhat *more* than one-third as many settlements as it deters. The basic point, however, remains.

Early settlements may be *less* efficient in two critical ways, however. First, settlements may start to occur *too early*, before the parties learn key facts about each others' legal positions, then the settlement amount may be an inaccurate estimate of the claim's expected value—and therefore an inaccurate result in terms of apportioning legal responsibility where it is and is not deserved.[86] Inaccurately estimated settlements inefficiently set the defendant's liability higher or lower than is optimal for deterrence and compensation purposes, the twin goals of civil liability.[87] Too-low liability leaves defendants insufficiently incentivized to consider the harms they cause; too-high liability overdeters defendants' activities.[88] To the extent that a ban induces parties to "jump the gun" and settle before they know enough to estimate expected liability accurately, a confidentiality ban may make settlements less efficient.

Second, increasing defendants' incentives to settle early would induce defendants to expend more prefiling legal and administrative costs on the following types of measures: more extensive and elaborate investigations, both internal investigations and investigations of individual plaintiffs; legal research; internal meetings, which can be disruptive and costly in terms of lost productive time; and settlement efforts in the form of expensive formal mediation rather than simple bilateral negotiation. These increased prelitigation costs could offset some of the saved litigation costs, but certainly not all of those costs, given how expensive actual litigation is compared to even the most elaborate prefiling efforts.

In response to both of these potential problems with "too early" settlements—inaccurate early settlements and increased early expenses geared toward settlement—there is reason to think that many settlements currently occur *too late* in the litigation process, later than the point at which the parties know enough to estimate expected value with enough accuracy to settle. If so, then a policy (like a confidentiality ban) that induces earlier settlement, and earlier investment in settlement efforts, might not be accelerating settlement to a point too early in litigation.

There are three key reasons that settlements currently occur later than necessary. First, mutual optimism often prevents early settlement, whenever the parties' combined litigation costs, their incentive to settle, are less than the divergence in the parties' EV expectations, their disincentive to settle.[89]

Second, attorneys' own incentives, as distinct from their clients', may lead them to postpone settlement. Attorneys paid by the hour may have a troubling self-interested incentive: to bill as many hours as possible before

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86. *See* BONE, *supra* note 27, at 210 ("Settlements based on a full factual record are more likely to reflect accurate trial outcomes and correspond more closely to the substantive law.").

87. *See* POLINSKY, *supra* note 27, at 24–26 (noting, for example, that with liability set too low, a defendant will undertake a greater-than-efficient amount of the activity that harms the plaintiff).

88. *See id.*

89. *See supra* Section I.A.2.

settling, not to settle as early as is feasible.[90] At least at the margins, an hourly-paid attorney considering settlement may give in to the temptation, conscious or not, to litigate a bit more before seriously exploring settlement.[91] This divergence between the interests of the principal (the client) and the agent (the hourly-paid attorney)[92] would tend to delay settlement unnecessarily.

Third, even if parties settle at a point appropriate in light of *their own* litigation costs, they still tend to settle later than is efficient, because they do not consider the costs of judicial administration. As discussed above, parties settle when the remaining litigation costs exceed the difference in their estimates of the case's expected value.[93] Even if the parties accurately estimate their own litigation costs, however, they have no incentive to consider judicial administration costs, such as the costs of running a courthouse and employing the judge and courthouse staff. At the margins, some parties will deem it not quite worth settling to save their litigation costs even though they would deem it worth settling if they had to consider the judicial administration costs their litigation imposes. Thus, parties have an incentive to settle later than is efficient because they externalize part of the cost of litigation onto the public; this is a negative externality of litigation that makes parties over-utilize the courts and under-utilize settlement, even if they accurately assess all costs, benefits, and probabilities.

Accordingly, early settlements are more efficient in terms of saving litigation costs, and it is unclear whether they would accelerate settlement to a point too early for the parties to estimate liability accurately. Currently, there is reason to think that settlement occurs later than necessary, so accelerating settlement would save litigation costs while possibly not sacrificing settlement accuracy—depending, of course, on the exact extent of the current "delayed settlements" problem, and on the degree to which a confidentiality ban accelerates settlement.

Yet the big picture is even more indeterminate. The net effect on settlement of banning confidentiality is not the clear "less settlement" effect that traditional economic analysis posits. There are two competing effects, and it is unclear which dominates, (a) defendants' greater willingness to make settlement offers prefiling (a positive change possibly lessened if earlier settlements are less accurate) or (b) defendants' lesser willingness to make

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90.   BONE, *supra* note 27, at 98–100 (noting concern that attorneys "will reject or delay settlement in order to run up billable hours").

91.   *See id.* at 99. Of course, whereas most defendants' lawyers are paid on an hourly basis, many plaintiffs' lawyers are paid a contingency fee (a percentage of the verdict or settlement). A contingency fee incentivizes plaintiffs' lawyers to settle *earlier*, not later, in the litigation. *Id.* at 101. It takes two sides to settle, and defendants' lawyers' incentive to delay settlement is *exacerbated* by plaintiffs' eagerness to settle, because that eagerness would induce a rational defendant to lower its settlement offer. *Id.* The defendant's lower offer would further delay settlement. *See id.*

92.   *See* PINDYCK & RUBINFELD, *supra* note 25, at 608–09 (defining "principal-agent problem" and explaining how it results from asymmetric information: the agent knows more about its own work than the principal does, so the agent can serve its own interests at the expense of the principal's).

93.   *See supra* Section I.A.1.

settlement offers postfiling. As a practical matter, in some cases, and with some parties, one effect may dominate the other.

Despite the presence of competing incentives with a murky net effect, two clear conclusions can be drawn from this Section's analysis. First, this analysis undercuts the traditional economic diagnosis that banning confidentiality both decreases defendants' willingness to settle and increases litigation costs. Second, encouraging of prefiling settlements is a promising benefit of banning confidentiality that has gone substantially unnoticed by the existing literature.

### 3. *The Broader Phenomenon: Insufficiently Comprehensive Regulation Producing Unintuitively Skewed Effects*

As discussed above, any ban on confidential settlements would have a systematic "gap": it would not reach prefiling settlements. That gap is the cause of the unintuitive conclusion that banning settlement confidentiality would encourage prefiling settlements. This is an example of a broader phenomenon: when regulations have systematic "gaps" in their enforceability, parties are incentivized to shift their activity into that gap, which can make the regulation have results unintuitively *opposite* those intended. Other examples of this phenomenon have been noted elsewhere:

- Banning employment discrimination may *increase* discrimination in hiring. Hiring discrimination is harder to catch than firing or on-the-job discrimination such as unequal pay or harassment, so (1) hiring women or minorities may *increase* employers' risk of discrimination suits, whereas (2) hiring fewer "protected class" workers (i.e., discriminating in hiring) may, perversely, *decrease* employers' risk.[94]

- Workplace accommodation mandates (such as disability accommodations,[95] family/medical leave,[96] or pregnancy leave[97]) may backfire, harming the intended beneficiaries. Employers forced to accommodate certain workers are incentivized either to pay those workers less or to avoid hiring them: if it is harder to police wage discrimination, the discrimination will be in lower wages; if it is harder to police hiring discrimination, employers will discriminate in hiring. Either way, if the discrimination laws have a "gap," with either wage or hiring equity less enforceable than accommodation mandates, then accommodation mandates may increase discrimination.[98]

- A safety regulation can *decrease* safety if it is insufficiently comprehensive. Holding a manufacturer liable for injuries its product causes can lead to *more* injuries if increased liability raises prices and thereby

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    94.   Scott A. Moss, *Women Choosing Diverse Workplaces: A Rational Preference for Both Occupational Segregation and Economic Analysis of the Law*, 27 HARV. WOMEN'S L.J. 1, 72 (2004).

    95.   Americans with Disabilities Act, 42 U.S.C. §§ 12101–12213 (2000).

    96.   Family and Medical Leave Act, 29 U.S.C. §§ 2601–2654 (2000).

    97.   Pregnancy Discrimination Act, 42 U.S.C. § 2000e(k) (2000).

    98.   Christine Jolls, *Accommodation Mandates*, 53 STAN. L. REV. 223, 255–56 (2000).

> shifts demand away from the product and toward less safe "off-system
> alternatives." For instance, if the price of produce jumps due to liability
> for pesticides, consumers may shift to cheap processed snack foods that
> may be less healthy than even pesticide-drenched produce.[99]

These examples show that, usually, a gap in the enforceability of a rule
is a troubling thing; shifting activity into less effectively regulated areas can
worsen the problem the regulation had targeted. However, the gap in the
enforceability of a confidentiality ban—its inability to reach prefiling set-
tlements effectively—is not so clearly a bad thing. To be sure, the gap is a
loophole allowing some secrecy to remain, which to some extent subverts
the ban. But this gap has benefits too, in that it could mitigate the key nega-
tive effect of a ban: (1) by encouraging prefiling settlement, it would
mitigate a ban's anti-settlement effects; and (2) by inducing earlier (prefil-
ing) settlements, it would save litigation costs, mitigating the concern that a
ban would increase litigation costs by leaving dockets clogged and inducing
more litigation. Accordingly, the gap in the enforceability of a confidential-
ity ban, far from a wholly unfortunate loophole, is at least in part a happy
accident that saves the regulation from its worst potential qualities: deterring
settlements and increasing litigation costs.

### B. *Low-Value vs. High-Value Cases: Settlement Incentives*
### *Varying Based on the Value of the Case*

As discussed above, contrary to the analyses of the existing literature,
banning confidentiality of settlements would have a dual effect: *increasing*
parties' incentives to settle *before* the complaint filing, but *decreasing* their
incentives to settle *after* filing. The existing literature also fails to note that
the strength of these incentive effects will vary based on the monetary value
(the EV) of the lawsuit—but that variation traces to multiple complex fac-
tors, making it hard to predict whether the effects will be stronger for high-
or low-EV lawsuits.

In the traditional model, the incentive effects of a confidentiality ban are
strongest in high-EV suits: banning confidentiality would affect settlement
of high-EV cases more than of low-EV cases.[100] However, the reality is far
more complicated and far less predictable. This Section illustrates how mis-
leading the traditional view's simpler conclusion can be.

The dual effect of banning confidentiality—more prefiling settlements,
fewer postfiling settlements—exists because the settlement range (S) con-
sists of not only monetary cost ($S_M=C_P+C_D$, the litigation costs that
settlements save), but also reputational cost ($S_R=pL_R$, the reputational cost of
a plaintiff's verdict that a settlement saves the defendant). It is the

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99.  *See infra* Section II.D.2.

100.  *See supra* Section I.B (noting that the way banning confidentiality decreases settlement
is by eliminating the reputational part of the settlement range ($pL_R$), an impact that is greatest when
the claim is meritorious (when p is high) and when the alleged injury is substantial (when $L_R$ is high,
which will tend to be in high-level injury and damages cases)—that is, in high-value cases).

reputational cost's presence prefiling, coupled with its absence postfiling, that encourages prefiling settlement but discourages postfiling settlement. A confidentiality ban eliminates $S_R$ (i.e., a settlement no longer would save reputational costs), so the question is, how significant a portion of the settlement range (S) is reputational cost ($S_R$)? Perhaps most of the settlement range is monetary ($S_M$), i.e., parties are motivated mainly by litigation cost savings, with reputational concerns secondary; or perhaps reputational costs ($S_R$) are the more significant inducement to settle.

This Section will illustrate a previously unnoticed point about the effects of banning confidentiality: the relative sizes of the monetary ($S_M$) and reputational ($S_R$) components of the settlement range will depend on the lawsuit's EV. This means that *the effect of banning confidentiality will differ for large and small lawsuits.* The question is, which rises more rapidly as the EV of a suit rises, the monetary component ($S_M$) or the reputational component ($S_R$) of the settlement range? The graphs below depict the question visually: as EV rises, which rises more quickly, $S_M$ (the left graph) or $S_R$ (the right graph)?[101]
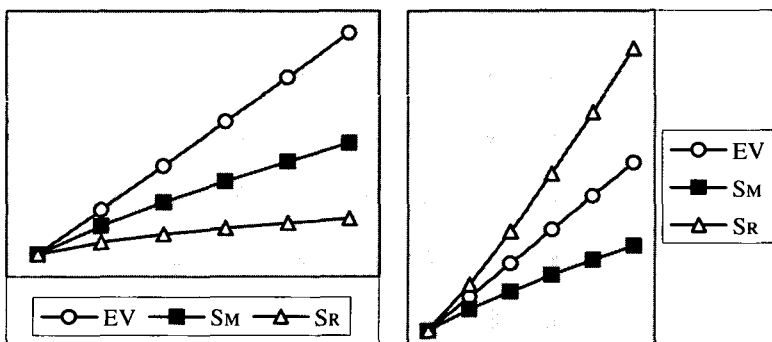


If the reputational element ($S_R$) rises more rapidly than the monetary element ($S_M$), then for high-EV suits, $S_R$ will be more important than $S_M$ compared to their significance in low-EV suits; the dual incentive effects of a confidentiality ban will be stronger in high-EV suits. In contrast, if the monetary component rises more rapidly, then for high-EV suits $S_M$ dominates $S_R$; the effects of a confidentiality ban will be weaker in high-EV suits than low-EV suits.

The EV of a lawsuit is $pL_M$, so to examine what happens to the monetary ($S_M$) and reputational ($S_R$) components of the settlement range as EV rises, we must examine what happens to $S_R$ and $S_M$: (1) as p rises (i.e., as the likelihood of the plaintiff prevailing rises), and (2) as $L_M$ rises (i.e., as the monetary stakes rise). The first question—what happens to $S_R$ and $S_M$ as p rises—is the easier one, but nevertheless there is no obvious answer. The

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101.    Both graphs assume that $S_M$ (the sum of the parties' litigation costs) rises more slowly than EV does, an assumption explained below. Thus, the key difference between the two graphs is whether $S_R$ rises more or less rapidly than EV does.

second question is far more complex; the answer is that there is a multifaceted relationship between EV and the strength of the effects of banning confidentiality, but that relationship is complex and unpredictable. Thus, it seems likely that banning confidentiality would have different effects on high-EV and low-EV suits, but it is difficult to predict which type of suit would be more strongly affected, contrary to the traditional model's clear but oversimplified prediction.

### (1) What happens to $S_R$ and $S_M$ as p rises?

Because $S_R = pL_R$, we know that $S_R$ rises proportionately as p rises. In contrast, $S_M = C_P + C_D$, so $S_M$ does not appear to rise at all as p rises,[102] but that appearance may be misleading. As EV rises, parties spend more on litigation (i.e., $C_P$ and $C_D$ may rise), because with higher stakes, there are higher returns on the "investment" of litigation costs.[103] Accordingly, $S_M$ likely does rise as p rises (because higher p means more litigation spending), but probably not proportionately, because of limits at both extremes, as explained below.

For *high-EV* cases, there is a limit to how much more attorney time one can spend on litigation. For example, the federal rules presumptively limit the number and duration of depositions to ten seven-hour days;[104] and once a summary judgment or other motion is well-researched and polished to a certain level, it cannot get much better. For *low-EV* cases, certain litigation costs cannot be eliminated or cut meaningfully past a certain point. For example, the time spent at certain mandatory court appearances may not vary at all based on the merits of the case; basic client meetings and phone calls can vary in length but have some minimum; and the time spent on certain filings, such as motion papers or mandatory pretrial papers like jury instructions, cannot be cut to zero.

In short, as p goes from (for example) 0.20 to 0.10 and then to 0.05, litigation costs typically cannot be halved, and then halved *again* (and the same goes for increases in p). On the whole, as the probability of a plaintiff's victory (p) rises, litigation costs likely do rise, but less rapidly than the rise in p, so $S_R$ rises more rapidly than $S_M$. Consequently, as the probability of a

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102. Formally (for those trained in basic calculus):

$$\frac{\partial(S_R)}{\partial(p)} = \frac{\partial(pL_R)}{\partial(p)} = L_R \quad \text{and}$$

$$\frac{\partial(S_M)}{\partial(p)} = \frac{\partial(C_P + C_D)}{\partial(p)} = 0.$$

103. *See, e.g.*, BONE, *supra* note 27, at 217 (providing an example of how parties' discovery spending rises as the amount of potential liability rises).

104. FED. R. CIV. P. 30. Courts may extend the limit beyond ten deposition days in large cases, *id.*, but not always, and certainly not proportionately to the dollar value of a case. For example, in a multi-million dollar case, the stakes may be fifty times as large as in the average federal lawsuit, but the court is highly unlikely to allow fifty times as many depositions (i.e., 500 depositions).

plaintiff's victory rises, the reputational motivation to settle ($S_R$) increases in importance compared to the monetary motivation, $S_M$. Because banning confidentiality is an *elimination* of $S_R$, the effects of such a ban would be stronger in high-p cases, in which $S_R$ is more significant, than in low-p cases, in which $S_R$ is less significant. As discussed below, however, we cannot as plausibly predict the effects of a rise in $L_M$, the monetary stakes, on the relative sizes of $S_R$ and $S_M$.

### (2) What happens to $S_R$ and $S_M$ as $L_M$ rises?

The second question—what happens to the relative sizes of $S_R$ and $S_M$ as $L_M$ (the monetary stakes) rises—is much more difficult to answer. As discussed above, when EV rises, litigation costs often do rise, but at a declining rate, so as $L_M$ rises, $S_M$ rises as well, but less than proportionally.

What happens to $S_R$ as $L_M$ rises is the trickier question. Because $S_R$ is $pL_R$, the question is what happens to $pL_R$ as $L_M$ rises. The p factor of $pL_R$ is irrelevant, because there is no relationship between p and $L_M$; i.e., there is no reason to think that big-money cases are more meritorious than small-money cases. Therefore, the question really is what happens to $L_R$ as $L_M$ rises; i.e., as the size of a public verdict or settlement ($L_M$) increases, how much more reputational cost ($L_R$) does that verdict impose? It is safe to assume that $L_R$ does in fact rise as $L_M$ rises, because big verdicts are more embarrassing to defendants than small ones, but the question is, how rapidly? The answer depends on the assumptions made, and here it is hard to declare one assumption more well-founded than another.

On the one hand, it seems likely that as $L_M$ rises, $L_R$ rises *at a declining rate*, just like $S_M$, the litigation costs. For example, four $50,000 verdicts could, other things equal, impose more reputational cost than one $200,000 verdict, perhaps by indicating that this particular defendant (a) gets sued frequently and presumably is likely to have actually done something wrong, like a doctor sued frequently for malpractice or (b) is quick to settle and for that reason seems an "easy mark" for plaintiffs.[105] A doctor might be a good example of a defendant who would fear one $200,000 verdict less than four $50,000 verdicts. The sheer number of malpractice lawsuits against the doctor might be relevant to the doctor's reputation, even apart from the total amount he or she pays in liability. That is, $200,000 in *one lawsuit* against a doctor may not harm the doctor's reputation as much as $200,000 in four lawsuits against that doctor. To the extent that this example is an accurate characterization of many defendants, then as $L_M$ increases by a multiple of four (from $50,000 to $200,000), $L_R$ increases by less than four times.[106]

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105. *See supra* notes 52–54 and accompanying text (recounting these harms to defendants from disclosures of prior settlements).

106. The same would be true for other multiples than four, of course. Formally:

$$\frac{\partial(L_R)}{\partial(L_M)} > 0 \quad \text{and} \quad \frac{\partial^2(L_R)}{\partial(L_M)^2} < 0$$

On the other hand, it is possible that as $L_M$ rises, $L_R$ rises *at an increasing rate*, at least once $L_M$ gets high enough, for two reasons. First, perhaps small verdicts or settlements convey little or no information about a defendant's culpability (only that some minor or frivolous lawsuits succeed to some extent), whereas "[v]ery large settlements ... might suggest that the defendant was guilty," as would large verdicts.[107] Second, even if numerous verdicts of, say, $50,000 might be more informative than one $200,000 verdict (as to both whether the defendant breaks the law and how willing the defendant is to settle), the one big verdict could draw much more unwanted attention. Behavioral economists have noted that unusual news, such as an unusually large verdict, is more salient to readers and therefore draws disproportionate attention, even to the point of skewing readers' perceptions. This bias in perception leads people to overestimate the likelihood of large verdicts, plane crashes, or other freak events that draw disproportionate public attention.[108]

Consequently, we cannot really say whether, as $L_M$ rises, $L_R$ rises at an increasing or decreasing rate. The answer may well be "both," in two ways. First, perhaps defendants' reputational concerns vary: some industries or individual companies may be most fearful of many small frivolous suits (in which case $L_R$ would not rise as much as $L_M$); but others may fear mainly the large, ruinous suit (in which case $L_R$ would be very low for a low $L_M$ but would increase rapidly as $L_M$ rises).

Second, perhaps as $L_M$ increases, $L_R$ rises initially at a decreasing rate, but then at an increasing rate because at very high levels of $L_M$, "big cases" draw disproportionate attention. Each of these two possible explanations means that the relationship between $L_R$ and $L_M$ is quite complex. In the first explanation, any model of $L_R$ and $L_M$ would need a separate variable for each industry, or each defendant "type," with different reputational concerns. In the second explanation, an appropriate model of $L_R$ and $L_M$ would feature an "inflection point" at which the rate of increase of $L_R$ would accelerate dramatically. Either way, such a complex relationship between $L_R$ and $L_M$ makes it difficult not only to choose realistic assumptions, but also to undertake any empirical modeling.[109] And either way, what little the

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107.  Lothes, *supra* note 26, at 462.

108.  *See, e.g.*, Jolls, Sunstein, & Thaler, *supra* note 43, at 1518–19 (explaining how people make inaccurate probability estimates based on two cognitive errors: (1) the "availability" heuristic—that "judgments about probabilities will often be affected by ... how easily such instances come to mind," so policy is "driven by recent and memorable instances of harm" and (2) the "salience" heuristic—that people give greater weight to emotionally striking news such as asbestos in schools than to more serious everyday risks like as "poor diet and exercise"); STEPHEN BREYER, BREAKING THE VICIOUS CIRCLE: TOWARD EFFECTIVE RISK REGULATION 35–36 (1993) (noting that people "react more strongly, and give greater importance, to events that stand out from the background," and recounting evidence that the media give such events disproportionate coverage).

109.  The more variables are included in a statistical model, the less precise and reliable the model becomes. *See* DAMODAR N. GUJARATI, BASIC ECONOMETRICS 60, 61 n.13 (2d ed. 1988) (explaining that standard error, "[a] measure of 'reliability' or precision" of the estimators a regression analysis yields, increases (i.e., there is *less* reliability and precision) with "the number of degrees of freedom[:] ... the total number of observations in the sample ... less the number of ... constraints

traditional model has to say about confidentiality's incentive effects on high-versus low-EV suits is oversimplified to the point of being incomplete and incorrect.

### C. *More Information on Settlement Values: Decreased Uncertainty Leading to More Early Settlements and Less Frivolous Litigation*

#### 1. *Less Divergence in Parties' Initial Beliefs*

A key reason that parties often have divergent beliefs as to the claim's expected value is that their initial information is incomplete,[110] and sometimes asymmetric, such as when a single defendant knows about the claims of numerous unrelated plaintiffs who are unaware of each other.[111] The more incomplete the parties' information, the greater the possible divergence, and the less likely that the parties settle; the more complete their information, the lesser the possible divergence, and the more likely that the parties settle.[112]

A ban on confidentiality would make more settlements public compared with the status quo, in which virtually all are confidential.[113] One noted anti-confidentiality argument is that disclosure "alerts future plaintiffs with credible cases, thus increasing the fraction of viable suits and promoting . . . compensation and deterrence."[114] The pro-confidentiality counterargument is that disclosure would promote more nuisance suits than credible cases.[115]

Much less discussed in the literature is the extent to which more settlement disclosure would facilitate settlement by helping even plaintiffs who already know they have claims, and the defendants who face them better estimate the value of those claims. When more settlements are public, other attorneys and parties can make better estimates of the settlement values of their own claims, because they can see the settlement amounts—the "pL" estimates—in prior similar cases.[116] No one prior settlement is likely to be an exact precedent, of course, because individual cases vary as much as snowflakes. Among employment lawsuits, for example, plaintiffs each have

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or restrictions put on them," indicating that regressions become less precise, even less feasible, as more variables (e.g., types of defendants) must be incorporated into an economic model).

    110.    *See supra* notes 47–51 and accompanying text.

    111.    Daughety & Reinganum, *Hush money, supra* note 23, at 664 (noting that in evaluating settlement confidentiality, one relevant model is that "a sequence of uninformed plaintiffs makes settlement demands of an informed defendant whose culpability in the . . . cases is correlated").

    112.    *See supra* notes 47–51 and accompanying text.

    113.    *See supra* notes 1–3 and accompanying text.

    114.    Lothes, *supra* note 26, at 457; *see also* Daughety & Reinganum, *supra* note 16, at 592 ("The disposition of P1's suit is likely to affect the probability that P2 makes the connection between her injury and D's activity.").

    115.    *See, e.g.,* Epstein, *supra* note 54.

    116.    *E.g.,* POSNER, *supra* note 27, at 570 (noting that widespread confidentiality hurts later plaintiffs by denying them information on settlement values); Miller, *supra* note 20, at 485 n.286 ("Those contemplating or involved in similar litigation obviously would have a great interest in the terms of [another party's] settlement.").

unique work histories and job qualifications; the employee and the employer's decision-makers each have unique personal qualities; and employers vary as to a host of workplace details (e.g., anti-discrimination procedures).[117]

But while no case will settle merely based on the settlement amount of a prior similar case, certainly a range of "prior comparables" can provide a ballpark range of settlement values, just as houses are unique but any legal assessment of a house's value commonly looks to the prices of "comparable" properties, even if no one other property truly is that similar.[118] It would at least be informative for parties in an employment dispute to know the settlements reached by prior employees in similar jobs with similar claims against similar employers. Various court filings, including the typical federal court complaint,[119] likely contain these and more details about the employee, the employer, and the legal claims at issue.[120]

Public disclosure of settlement amounts could narrow the range of disagreement among the parties by dissuading them from making extreme settlement offers. Even if settlements of similar claims have varied by a factor of ten—for instance, if various female stockbrokers' discrimination claims settled for anywhere from $50,000 and $500,000—that data would make it harder, in a later such lawsuit, for the defendant to stick to a "nuisance-value" offer (such as $5,000)[121] and for a plaintiff to demand a

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117.    *E.g.*, Reeves v. Sanderson Plumbing Prods., Inc., 530 U.S. 133, 148–49 (2000) (holding that, in discrimination case, "[w]hether judgment as a matter of law is appropriate in any particular case will depend on a number of factors . . . [such as] the strength of the plaintiff's prima facie case, the probative value of the proof that the employer's explanation is false, and any other evidence that supports the employer's case and that properly may be considered . . . ."); McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802 n.13 (1973) ("The facts necessarily will vary in Title VII cases, and the . . . proof required . . . is not necessarily applicable in every respect to differing factual situations.").

118.    *See, e.g.*, Niagara Mohawk Power Corp. v. Assessor of Geddes, 699 N.E.2d 899, 900 (N.Y. 1998) (reversing a lower court holding that held that it is inappropriate to value "specialty" properties through the use of a comparable sales method); Great Atl. & Pac. Tea Co., Inc. v. Kiernan, 366 N.E.2d 808, 812 (N.Y. 1977) ( "[F]acilities such as utility tunnels, employee walkways, truck loading docks, refrigeration facilities or the like do not render the subject property a specialty incapable of valuation according to the normal market value method.").

119.    Even in the rare cases in which courts seal settlement filings, the plaintiff's complaint is sealed only three percent of the time. *See* REAGAN ET AL., *supra* note 8, at 1.

120.    *See, e.g.*, Complaint, Mansfield v. Billington, 432 F. Supp. 2d 64 (D.D.C. 2006) (No. 05CV01790), 2005 WL 2861435 (federal court complaint by middle-management federal government employee with roughly twenty-five years of tenure alleging (1) Equal Pay Act and Title VII claims of sex discrimination in compensation, in that she performed the same work as men in a higher pay grade but was classified at a lower pay grade; and (2) that she suffered a retaliatory demotion after she complained about the pay discrimination); Complaint, Taylor v. United Parcel Serv., Inc., 421 F. Supp. 2d 946 (W.D. La. 2006) (No. CV 03-0516-S), 2003 WL 23768755 (federal court complaint by African American male UPS official with roughly twenty-seven years of tenure alleging racially discriminatory denials of equal compensation and of deserved promotions to "division manager" and higher positions repeatedly over at least ten years).

These pleadings contained a good deal more detail, but the point is that merely scanning the basic details of a filed complaint can be very helpful for a would-be plaintiff (or, more likely, her attorney) seeking to find comparable cases.

121.    *See, e.g.*, Fletcher v. City of Fort Wayne, 162 F.3d 975, 976 (7th Cir. 1998) (denying two police brutality plaintiffs any attorneys' fees as "prevailing parties," because settlements of $2,500 and $5,000 were settlements defendant made merely to avoid the "nuisance" of the lawsuits). "A

million-dollar settlement. It is a common strategy among litigators to agree to a serious settlement effort, such as formal mediation, only after the other side makes a credible settlement offer.[122] Whereas the conventional wisdom is that more data on cases' settlement values would encourage more litigation,[123] this analysis shows how it could advance and accelerate settlement of filed cases.

## 2. *Less Incentive to File Negative-Value Suits*

There is another, less intuitive benefit of the greater public information yielded by a confidentiality ban: as noted in a recent groundbreaking paper, "increased uncertainty in the litigation process will generate a greater incentive to file more undesirable lawsuits," specifically more lawsuits with a "negative expected value" ("NEV") in the sense that the litigation costs outstrip the potential benefits to the plaintiff.[124] This is exactly contrary to one frequently cited pro-confidentiality argument: that more disclosure will generate more frivolous litigation.[125]

Why plaintiffs ever would file NEV suits is an economic riddle that has many possible answers.[126] Joseph Grundfest and Peter Huang add a new answer by analyzing litigation and settlement decisions based on "real options theory."[127] One of "the tools applied to the economic analysis of research and development projects," real options theory models litigation "as a series of decision points":[128] significant case developments (e.g., key testimony or rulings) yield information that makes parties adjust their strategies, perhaps the plaintiff abandoning the case or the defendant raising its settlement offer.[129]

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compromise for less than the costs of defense is a good working definition of a nuisance-value settlement, unless . . . the stakes of the case are themselves small." *Id.*

122.    This was the author's own strategy in employment law practice, and it is common advice for litigators, both plaintiff- and defendant-side. *See, e.g.,* H. Thomas Fehn, et. al., *Securities Arbitration Mediator Model SA-1(m)(f)—User's Manual,* 1383 PRAC. L. INST. (CORP.) 371 (2003) (offering this advice for fellow defense attorneys); Brian N. Smiley & Steven J. Gard, *A Message to Mediators,* 1503 PRAC. L. INST. (CORP.) 435, 439 (2005) (offering this advice for fellow plaintiffs' attorneys). Smiley and Gard further explain this advice as follows:

> [W]e do not want to go into the mediation only to learn that the other side has not yet given serious thought to the settlement value . . . . If they in fact perceive this as a "cost of defense" case, we see little reason to educate them about the merits prior to the hearing . . . [and] no need for either party to incur the expense of a mediator. . . .

*Id.*

123.    *See supra* notes 52–54 and accompanying text.

124.    Grundfest & Huang, *supra* note 28, at 1316.

125.    *See supra* notes 52–54 and accompanying text.

126.    *See supra* note 52.

127.    Grundfest & Huang, *supra* note 28.

128.    *Id.* at 1270, 1273.

129.    *Id.* at 1279.

Viewing lawsuits as a series of decision points, Grundfest and Huang observe that a plaintiff may rationally pursue an NEV claim by investing only a portion of the litigation costs in some initial stages of the dispute, such as filing a court complaint and taking some minimal discovery (or just filing a prelawsuit administrative complaint[130]) in the hopes that these limited steps yield either useful information or a quick settlement.[131] If this limited investment does not produce any useful information or settlement, the plaintiff can abandon the claim after spending a small amount. In this sense, filing a case is "buying an option" to litigate, allowing the plaintiff to wait to see if a weak claim improves due to some unexpected development: a defendant proving especially antsy to settle; limited discovery unearthing a smoking gun; a surprising judicial decision favoring the plaintiff; or even just drawing an unusually pro-plaintiff judge.[132] In short, if the plaintiff sees sufficient uncertainty about such matters, including uncertainty as to what the defendant would pay, then it may be worth at least a limited effort to pursue a claim that initially appears to have a negative value.

This theory explains how a plaintiff's lawyer may pursue a number of NEV claims tentatively, through some initial litigation stages, and then abandon most but continue with the few that enjoy some surprising good news in the initial stages. If most claims that appear to be NEV prove worthless, but a few turn out after limited expenditure to have a high payoff, then investing in many NEV suits may be a profitable strategy. Undertaking an NEV claim thus is like buying an option currently worth little: it will likely prove worthless, but there is a small chance that changed circumstances will make it valuable, so it may be rational to purchase many such cheap low-value options, that is, to file many NEV suits, invest little in the early stages of each, and see which proves to be a winner.[133]

The fact that pursuing NEV claims is a winning strategy only if a few prove to be big winners "suggests that 'riskier' lawsuits can be more valuable to . . . plaintiffs than 'safer' lawsuits if the plaintiff is able to reduce or eliminate his litigation expenditures sufficiently in the event the lawsuit evolves poorly."[134] "Riskier" lawsuits here means "that the lawsuit's variance is sufficiently high," most notably if most are of zero or negative value while

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130.  For example, most federal employment discrimination complaints must be preceded by an administrative filing with the Equal Employment Opportunity Commission, which has at least 180 days (more if the complainant consents) to investigate and reach a nonbinding conclusion on the merits of the complaint. *See* Title VII of Civil Rights Act of 1964, 42 U.S.C. §§ 2000e-5(e) to -(f) (2000). Cooperating with this 180-day investigation-to-ruling process can be a low-cost initial investment in a legal claim.

131.  Grundfest & Huang, *supra* note 28, at 1277.

132.  *See generally* Robert A. Carp et al., *The Decision-Making Behavior of George W. Bush's Judicial Appointees*, 88 JUDICATURE 20 (2004) (noting wide variation in percentages of "liberal decisions" by judges appointed by different presidents, including unintuitive differences among different types of cases, e.g., criminal cases versus civil rights cases).

133.  The author, who before becoming a professor was a practicing plaintiff-side employment lawyer, knows of attorneys whose plaintiff-side practice involved this sort of "file en masse" tactic.

134.  Grundfest & Huang, *supra* note 28, at 1315.

a select few are of high value.[135] This "suggest[s] ... that uncertainty ... [in] litigation ... provides an incentive for plaintiffs to file a greater-than-optimal number of lawsuits."[136]

Given the link between uncertainty and NEV filings, banning confidentiality could *decrease* NEV filings by decreasing uncertainty as to the fate of similar lawsuits,[137] contrary to the pro-confidentiality argument that more settlement disclosure would *increase* frivolous litigation.[138] As discussed earlier, banning confidentiality decreases uncertainty about case value by clarifying the values of similar prior cases.[139] Most settlements, one recent study has shown, are for relatively modest sums; few settlements reach the seven-figure, or even high six-figure,[140] sums that populate newspaper headlines and inspire the greedy among us to dream of becoming plaintiffs.[141] Thus, one of the information-economics benefits of banning confidentiality is that more data about settlements will diminish the incentive to file an NEV lawsuit in the hopes that, after limited expenditures, a case will prove to be the one that beats the odds and yields a positive value.

Admittedly, it is far from *certain* that banning confidentiality would, *on the net*, decrease frivolous suits. To the extent that a ban increases the pressure on defendants to settle early, more frivolous plaintiffs may get settlement offers that they do not deserve. Moreover, Epstein and others may have a point in arguing that, to some extent, disclosed settlements inspire copycat lawsuits, some of them unmeritorious. The situation is not as bleak as Epstein depicts, however, because some of the "copycats" are deserving plaintiffs who simply had not known enough to sue.[142] Epstein's only re-

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135.   *Id.* at 1316.

136.   *Id.* at 1322.

137.   Grundfest & Huang provide a disclaimer for any inference that uncertainty breeds NEV filings: increasing uncertainty can mean more *or* fewer NEV filings, depending on the initial level of uncertainty. *Id.* at 1320–21. But they also note that (1) increasing uncertainty is most likely to increase NEV filings when the legal environment already was high in uncertainty; and (2) there is a great deal of uncertainty inherent in litigation. *Id.* Litigation very much seems like the sort of high-uncertainty endeavor in which a plaintiff's lawyer may file what appears to be a NEV suit as a "lottery ticket," in the hopes that after limited litigation cost expenditures, the case will emerge as one that beats the odds and yields positive value.

138.   *See supra* notes 52–54 and accompanying text.

139.   *See supra* Section II.C.1.

140.   Minna J. Kotkin, *Outing Outcomes: An Empirical Study Of Confidential Employment Discrimination Settlements* 64 WASH. & LEE L. REV. (forthcoming 2007) (examining recently disclosed data on confidential settlements collected in one judicial district and finding that (1) the median confidential settlement in an employment discrimination case was $30,000; (2) the median in personal injury lawsuits was $181,500; and (3) of the 455 discrimination settlements (the largest group studied), only *nine* (just under 2%) were above $300,000, and only 1 (0.2%) was above $1 million).

141.   *Id.* at 4 ("[N]ewspaper reports reflected an 85% win rate for plaintiffs with average recoveries of $1.1 million, when the docket entries showed a 32% win rate, and a recovery average of $150,000") (citing Laura Beth Nielson & Aaron Beim, *Media Misrepresentation: Title VII, Print Media, and Public Perceptions of Discrimination Litigation*, 15 STAN. L. & POL'Y REV. 237, 251–253 (2004)).

142.   *See supra* note 114 and accompanying text.

sponse to this is to assert that lawsuits are a bad way to redress even *clearly* wrongful conduct,[143] a position that proves too much: if we accept Epstein's premise that we should junk the entire tort system, then yes, we need not worry about confidentiality's effects on "worthy" lawsuits, because there is no such thing—but few would accept Epstein's premise.

Nevertheless, the fact remains that diminished uncertainty about the range of possible outcomes would dissuade those with low-odds cases from filing in the first place. If they know that a case is not only low-odds (because the claim is frivolous) but also unlikely to yield a six-figure damages award even if the plaintiff wins (the point that more settlement disclosure would make clear), then few plaintiffs with such claims will choose to pay lawyers' hourly rates, and even fewer lawyers will take such cases on a contingent fee. At the very least, how a confidentiality ban would impact frivolous litigation is far less clear, due to the presence of competing effects, than economic analysts to date have noted.

### D. *More Information on Settlement Values: Remedying Information Shortcomings That Induce Sub-Optimal Market Choices*

#### 1. *Remedying Self-Perpetuating Occupational Segregation*

The textbook free-market economic analysis of discrimination is that it cannot happen much in a reasonably free market. Discrimination is an irrational decision to forego good talent, as in refusing to hire qualified women or racial minorities, or to treat employees badly regardless of their value, such as by allowing harassment based on sex or race. Discrimination weakens an employer's existing talent pool, scares off applicants, and dims future prospects for attracting and retaining talent. Employers that discriminate lose out to competitors who do not discriminate, or at least forego profits by tolerating a lesser labor pool.[144]

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143.    *See* Epstein, *supra* note 54. Epstein questions the merits of various claims concealed by confidential settlements (such as claims of defective Firestone tires, when the tires had met "federal design specifications" and some plaintiffs had engaged in "improper maintenance and egregious use") but asserts that even as to clear cases of harmful, illegal acts, civil liability is inappropriate:

> Everyone must deplore the apparent breakdown in the internal procedures of the Roman Catholic Church, which failed to remove priests from positions of power for abusive behavior. But are lawsuits the best way to right these wrongs? . . . [P]ayment of high damages deprives the Church of money it needs to right itself . . . . [I]t makes more sense in serious cases to require that the Church report abusive priests to state officials, who can then take steps to ensure that offenders are removed from office and then charged with criminal offenses.

*Id.*

144.    See RONALD G. EHRENBERG & ROBERT S. SMITH, MODERN LABOR ECONOMICS 396–98 (8th ed. 2003) (explaining based on economic model: "[D]iscriminators give up profits in order to indulge their prejudices . . . . [I]f competitive forces were at work[,] . . . firms that discriminate would be punished and discrimination could not persist unless their owners were willing to accept below-market rates of return . . . ."); see generally GARY S. BECKER, THE ECONOMICS OF DISCRIMINATION (2d ed. 1971).

This "discrimination penalty"—the loss of qualified labor—is key to the argument that free markets exert competitive pressure against discrimination. The existence of a significant discrimination penalty, however, has been called into doubt on several fronts. First, discrimination may in fact be utility-maximizing for employers, both monetarily (even a nonbigoted employer may cater to racist customers or workers) and nonmonetarily (racist employers losing utility from interacting with African Americans).[145] Second, all employers in a field can lessen the competitive pressure not to discriminate by making a cartel-like agreement to discriminate, such as an understanding, among all employers in a certain industry or geographic location, that none of them will hire African-Americans.[146]

Third, and most relevant for present purposes, there is substantial doubt as to whether discriminating employers really lose future talent—that is, whether allowing discrimination truly hurts recruiting efforts. Discriminating makes recruitment harder only if potential hires *know* the firm discriminates. While discrimination once was overt and obvious, today it is harder to spot discriminatory employers: modern discrimination is concealed,[147] and nondiscriminatory employers may lack women or racial minorities due to historical chance or past discrimination, not current discrimination.[148]

Given this uncertainty as to which employers discriminate, for job applicants from discriminated-against groups, choosing more diverse workplaces over less diverse ones may be the best way to avoid discriminatory employers. This is an imperfect way to avoid discrimination, certainly; some workers, fearing discrimination, will opt against employers who do not actually discriminate—perhaps they are nondiverse due to random chance or past discrimination—to the disadvantage of both workers and employers alike. Workers who opt against truly nondiscriminatory employers are foregoing otherwise appealing job options; identically, the nondiscriminatory but nondiverse employer is losing out on talent that could have served it well.[149] Yet it still would be *rational*, though imperfect, for workers to

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145. RICHARD A. EPSTEIN, FORBIDDEN GROUNDS: THE CASE AGAINST EMPLOYMENT DISCRIMINATION LAWS 42–47 (1992); *see* POSNER, supra note 27, at 681–83, 686–88.

146. Robert Cooter, *Market Affirmative Action*, 31 SAN DIEGO L. REV. 133, 150–56 (1994) ("Discriminatory social groups are much like cartels, and a discriminatory norm is analogous to a price-fixing agreement . . . . [S]outhern whites actively used the power of . . . government to reduce competition from blacks through the [late nineteenth-century] 'Jim Crow' legislation . . . . "); Daria Roithmayr, *Barriers to Entry: A Market Lock-In Model of Discrimination*, 86 VA. L. REV. 727, 731 (2000); ("[C]oercive social norms and social payoffs . . . police discriminatory behavior in racist cartels.") (citing Richard H. McAdams, *Cooperation and Conflict: The Economics of Group Status Production and Race Discrimination*, 108 HARV. L. REV. 1003, 1046–48 (1995)).

147. Ramseur v. Chase Manhattan Bank, 865 F.2d 460, 464–65 (2d Cir. 1989) ("'Employers are rarely so cooperative as to include a notation in the personnel file that the firing is for a reason expressly forbidden by law.") (citation omitted); Segar v. Smith, 738 F.2d 1249, 1278 (D.C. Cir. 1984) ("The days of Bull Connor are largely past; discrimination now works more subtly.").

148. *See* Moss, *supra* note 94, at 35–42 (discussing ways even nondiscriminatory employers can wind up with large gender gaps).

149. *See id.* at 59–60 (noting losses both to workers from the discriminated-against group and to the nondiscriminatory employers they avoid for being nondiverse).

choose diverse over nondiverse workplaces; given how hard it is to spot discrimination in potential employers, the amount of diversity in a workplace is a rational proxy for the likelihood of discrimination.[150]

This state of affairs—workers choosing diverse workplaces—is an inefficient matching of workers to employers based on an asymmetric information problem: it is too costly (or impossible) for employees to know who discriminates; this information cost leads them to substitute imperfect criteria (level of diversity) that lead to imperfect decision-making. Disturbingly, there is no obvious solution. Nondiscriminatory employers who happen to be nondiverse cannot fix the situation for various reasons: trumpeting one's diversity/nondiscrimination programs is cheap talk now that even the most discriminatory employers feature such programs,[151] and affirmative action is limited by recent judicial decisions.

With more readily available information about which employers discriminate, employees' career decisions would be more efficient. Confidential settlements worsen this dearth of available information. Minna Kotkin titled her recent article *Invisible Settlements, Invisible Discrimination* because the problem with settlement confidentiality is that "invisible settlements make discrimination in the workplace invisible."[152] Kotkin spoke of the purposes and goals of anti-discrimination law, not of information economics, but much of the problem of discrimination can be viewed as a problem of economic inefficiency, and confidential settlements are no exception. By keeping discrimination hidden, confidential settlements keep information costs high for workers making career decisions, decreasing the efficiency of those decisions.

Conversely, banning confidentiality would require disclosure of more of the settlements an employer pays—critical information that could improve workers' career decisions. While not a perfect measure of discrimination at the employer, the number and amount of settlements is a far better proxy than raw percentages of women and minorities in that workplace.[153] Settlement amounts, after all, are based on the parties' estimates of the merits of the claim: the probability that the plaintiff proves discrimination and the estimated size of the verdict.[154]

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150.   *See id.* at 27–35.

151.   *Id.* at 26–27, 62–63.

152.   Kotkin, *supra* note 1, at 929.

153.   Of course, it makes the most sense for workers to rely on both pieces of information (settlements as well as diversity percentages). For example, a nondiverse employer (i.e., one with very few women or minorities) might have fewer discrimination lawsuits than a truly diverse firm of the same size, even if the nondiverse firm is more discriminatory—which could imply, misleadingly, that the firm does not discriminate. However, settlement data would remain useful because that discriminatory non-diverse firm's settlement amounts would be higher, and it would have more lawsuits per employee of the discriminated-against group. Thus, even though diversity percentages remain important information, more settlement data still would add value to workers' predictions about which employers would or would not discriminate.

154.   *See supra* Section I.A (outlining basic "expected value" model of settlement value).

Thus, while many companies get sued some amount, companies that actually discriminate more would tend to have (a) *more settlements*, because they would tend to have more lawsuits against them,[155] and (b) *more large settlements*, because the fact that they truly are "guilty" of discrimination means that their lawsuits would tend to have higher expected values. The amounts and sizes of discrimination settlements and verdicts against a company would be useful information for workers—an imperfect measure of the amount of discrimination, but better than just looking at the numbers of women and racial minorities at an employer, which currently is extensively reported by and about employers.[156]

## 2. Remedying the "Second Best" Problem of Tort Liability

The above point (that settlement disclosure could redress an information shortage that leads to over-avoidance) applies beyond employment markets. It is also relevant to, for example, investment markets (for instance, investors avoiding stocks because some companies engage in securities fraud) and product markets (consumers avoiding certain products because a few brands are dangerous). This Section discusses one such area, product markets and tort law, that has seen extensive application of a relevant economic theory: the theory of second best.

Tort scholars long have noted that consumers may avoid certain products, such as stepladders or fresh fruit with pesticides, because tort liability increases prices, which decreases the quantity that consumers purchase.[157] Avoiding a "dangerous" product, however, may actually worsen the danger, by diverting the would-be consumer to more dangerous "off-system alternatives." Customers may wind up standing on folding chairs or eating junk food, options that are far more dangerous than even imperfectly-designed stepladders or pesticide-sprayed fresh fruit, respectively.[158]

This is the "theory of second best," a half-century-old economic theory[159] that legal analysts rarely noticed until the past decade or

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155. Or, if the company refuses to settle, it would have few settlements but more plaintiff's verdicts against it, and all such verdicts (regardless of whether settlements can be confidential) are publicly available. Thus, for a company that discriminates more than others do, refusing to settle is not an effective way to avoid the bad publicity of public-knowledge settlements.

156. *See, e.g.*, NAT'L ASS'N FOR LAW PLACEMENT, 2006–2007 NALP DIRECTORY OF LEGAL EMPLOYERS (2006) (providing statistics on gender, race, disability, and sexual orientation at each major law firm).

157. *See* Stephen F. Williams, *Second-Best: The Soft Underbelly of Deterrence Theory in Tort*, 106 HARV. L. REV. 932, 934–36 (1993).

158. See *id.*

159. The leading early article on the theory of second best is R. G. Lipsey & Kelvin Lancaster's The General Theory of Second Best, which summarized it as follows:

> [I]f . . . a constraint . . . prevents the attainment of one of the [optimum] Paretian conditions, the other Paretian conditions, although still attainable, are, in general, no longer desirable . . . . [Once] one of the Paretian optimum conditions cannot be fulfilled, then an optimum situation can be achieved only by departing from all the other Paretian conditions. The optimum situa-

two.[160] In shorthand form, the theory cautions that "well-intentioned tinker-ing with a quirky, imperfect market can worsen matters . . . because efforts to correct only one market flaw can exacerbate other flaws."[161] Steven Wil-liams's application of second best theory sees *visibly* tort-inflated prices (which decrease demand) as the problem.[162] But more relevant to the confi-dential settlements debate is that the *invisibility* of certain hazards can worsen the problem.

If it is hard to distinguish between safe and unsafe products of similar kinds, the lack of information about which particular goods are the "bad apples" in the bunch exacerbates the basic second-best problem of hazards shifting demand to worse goods. That is, people switch to more dangerous off-system alternatives *both* because some products' prices are inflated by tort liability[163] and because of the information costs of distinguishing be-tween safe and unsafe products.[164] People may avoid a good entirely (for example, all stepladders, all fresh fruit, or all jobs in an industry with a high incidence of discrimination) and choose something worse.

Better disclosure of product liability settlements can help consumers know exactly which brands or types of a good are truly dangerous, espe-cially to the extent that a large cluster of public settlements would likely draw media attention (e.g., "Moss Hardware, the nation's leading producer of home improvement equipment, paid $X million in settlements this past year on claims of defective ladders"). Notably, "consumers" in this context includes companies that buy goods such as hardware, tools, or equipment. Even if it may be unlikely that individual consumers would monitor product safety in a no-confidentiality regime, it is likely that corporate consumers— or industry publications, trade associations, or advocacy groups such as

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tion finally attained may be termed a second best optimum because it is achieved subject to a constraint which . . . prevents . . . a Paretian optimum.

R. G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11, 11 (1956).

160.    A Westlaw search (theory /s "second best") for law review articles mentioning the theory found that it was almost never cited in the 1970s (21 articles), more frequently cited in the 1980s (102 articles), still more frequently cited in the 1990s (332 articles), and apparently is being cited with still increasing frequency in the 2000s (204 articles in just 2000–2005).

161.    Scott A. Moss & Daniel A. Malin, *Public Funding for Disability Accommodations: A Rational Solution to Rational Discrimination and the Disabilities of the ADA*, 33 HARV. C.R.-C.L. L. REV. 197, 218 (1998).

162.    *See* Williams, *supra* note 157. Williams's application of the theory has been controver-sial, derided as a "straw man" premised on truly excessive tort liability, *see* Carl T. Bogus, *War on the Common Law: The Struggle at the Center of Products Liability*, 60 MO. L. REV. 1, 26 (1995), and critiqued as potentially "an all-purpose rhetorical mace against regulation" that "proves [too] much," Jim Chen & Edward S. Adams, *Feudalism Unmodified: Discourses on Farms and Firms*, 45 DRAKE L. REV. 361, 367 (1997). At the very least, "a minimalist variant" of the argument—that tort liability can have these negative substitution effects, Chen & Adams, *supra* at 367—remains a worthwhile insight; it is that insight that will be the focus of this Article's discussion of the theory.

163.    *See* Williams, *supra* note 157.

164.    *See supra* Section II.D.1.

Consumers Union[165]—would have the incentive, expertise, and resources to undertake such inquiries. Moreover, even if the average consumer does not research or monitor many products,[166] news of major settlements, like news of major verdicts today,[167] would receive enough media airplay[168] to reach a broad audience.

More generally, better disclosure of settlements can mitigate the problem of people avoiding a consumer or labor market due to a few bad apples in that market. In short, when it's easier to spot the bad apples, it's easier to find and eat good apples.

### 3. *The Benefits of Information Disclosure: A Closer and Broader Look*

As discussed above, more settlement disclosure would help consumers and workers distinguish dangerous products and jobs from less dangerous ones. This would diminish the problem of those who are under-informed engaging in "over-avoidance" and shifting to inferior alternatives. These information benefits of disclosure should not be overstated, however, for two reasons.

First, more disclosure of product harms could worsen the second-best problem to some extent, such as consumers abandoning hand drills in favor of more dangerous off-system alternatives like creative use of sharp objects to "drill" holes. Second, settlement secrecy does not entirely cover up product hazards. Even secret settlements add to product costs, thereby increasing product prices (depending on the elasticity of demand[169]).[170] To the extent

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165.    The non-profit organization Consumers Union not only publishes *Consumer Reports*, a widely read magazine that reports information on a wide range of products, but also publishes more detailed product comparison and consumer fraud studies, such as *Hear This! Consumers Enjoy a Range of Hearing Aid Options, But Comparison Shopping Can Be Difficult* and *Access to the Dream: Home Mortgage Lending in Texas*. ConsumersUnion.org, Consumers Union Publications, http://www.consumersunion.org/aboutcu/publications.html (last visited Nov. 24, 2006) (listing studies conducted by Consumers Union). Such studies and publicity efforts would be facilitated by better litigation settlement data.

166.    The author admits that he knows almost nothing about the contents of his own toolbox, even though he risks injury, property damage, and embarrassment whenever he uses them.

167.    For example, the media have reported extensively on recent settlements and verdicts in lawsuits alleging deaths resulting from prescription pharmaceuticals. *See, e.g.*, Alex Berenson, *In the Money, and in Court; Drug Industry Braces for New Suits Over Even More of Its Products*, N.Y. TIMES, Apr. 22, 2006, at C1 (recounting, on front page of business section, numerous widely reported settlements: "Eli Lilly agreed to spend $700 million to settle 8,000 lawsuits over Zyprexa, a drug for schizophrenia that causes severe weight gain in many patients. Wyeth has spent $15 billion ... to resolve lawsuits over its fen-phen diet-drug combination, which can cause severe heart problems .... [A]nalysts estimate that Merck may eventually have to pay $10 billion to $50 billion to end the litigation over Vioxx, which has been linked to heart attacks and strokes.").

168.    *See supra* note 108 (noting disproportionate reporting of unusual events such as large verdicts).

169.    The extent to which a manufacturer can increase a good's price to recoup liability costs depends on the elasticity of demand for the product; if consumers can switch easily to other goods, the manufacturer cannot increase prices without losing sales. *See* PINDYCK & RUBINFELD, *supra* note 25, at 52 (noting that the more elastic demand is, the less any changes in supply costs can be passed along to consumers as price hikes).

170.    *See generally* Williams, supra note 157.

that the power drill that causes more injuries goes up in price relative to its safer rivals, then consumers will not over-avoid drills in favor of less safe off-system alternatives (creative use of sharp objects); they will simply be guided by the invisible hand to the drills that cost less because they are safer.

Whether disclosure will worsen or mitigate the second-best problem depends on whether the law can facilitate people's ability to distinguish hazardous and safe products—or jobs or investments—*in the same market* (e.g., different brands of tires, different kinds of power drills, or different employers in the same industry). To the extent that (1) people are unable to so distinguish, or there are no meaningful differences among products, and (2) there are viable off-market alternatives not subject to legal regulation, then more disclosure could worsen the over-avoidance problem.

There is reason to think, however, that more disclosure *can* improve people's ability to distinguish among products. Market prices are imperfect at reflecting product hazards, because a dangerous product's price is unlikely to rise enough to reflect the full costs of injuries; the shoddy production or neglectful management that caused the hazards may have been quite cheap, which would make the hazardous goods cheaper, and settlement costs typically fall short of full compensation.[171] Given the inability of prices to include all relevant hazard costs, consumers rationally seeking to avoid injury will tend to avoid *all* power drills (for example) in a market, even if only some are dangerous while others are safe, and perhaps only the safer drills are superior to the off-system alternatives. Better information on which drills lead to lawsuits can help consumers shift to the safe ones rather than away from all drills.

More broadly, when a market flaw inhibits efficient decision-making, mandatory information disclosure can be a useful and quite moderate effort to remedy that flaw. As to the problem of workers avoiding nondiverse (but not necessarily discriminatory) workplaces because they inaccurately fear discrimination there, a drastic solution would be to allow or even require aggressive affirmative action by such firms.[172] Current law, however, restricts permissible affirmative action and almost never *mandates* affirmative action, except as a remedy for specific evidence of widespread discrimination.[173] In contrast, mandatory settlement disclosure would be a far less drastic measure, far less burdensome on businesses than traditional "command and

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171.    Incomplete compensation by the tort system, even by verdicts rather than compromise settlements, is a reasonable assumption at least in terms of individuals' ex ante decision making, because people overestimate the negative impact of suffering a loss and underestimate their own ability to adapt. *See, e.g.,* Paul H. Robinson & John M. Darley, *Does Criminal Law Deter? A Behavioural Science Investigation,* 24 O.J.L.S. 173, 187–88 (2004) (noting that prisoners' disutility from imprisonment decreases the longer they stay in prison, because they adapt to that new reality). A full discussion of whether the tort system compensates accurately, incompletely, or excessively is beyond the scope of this Article.

172.    *See* Moss, *supra* note 94, at 74–76.

173.    *E.g.,* Martens v. Smith Barney, 181 F.R.D. 243, 261–62 (S.D.N.Y. 1998) (approving portion of proposed class action settlement with "set percentage goals for gender diversity in various job categories," reasoning that such provisions essentially are agreed-upon equitable relief).

control laws" directly regulating workplace diversity, product safety, or pollution.[174] While settlement disclosure would somewhat skew litigation settlement incentives,[175] it would not have the far more market-altering effect of, for example, affirmative action, which by its nature directly skews hiring and promotion decisions.

## CONCLUSION

This Article has attempted to move beyond the traditional economic debate about confidential settlements, which largely has been a trite point/counterpoint: they alleviate courts' overburdened dockets by efficiently facilitating settlement but also impose negative externalities by leaving dangerous situations undisclosed and unredressed. While economics by its nature "models" reality by simplifying it,[176] an economic model that neglects important variables is of little use, because we cannot "assume away" key realities. As the saying goes, "reality is that which, when you stop believing in it, doesn't go away."[177] Specifically, virtually all of the existing literature misses many of these nuances and complexities of litigation and settlement:

- A confidentiality ban could not effectively reach prelitigation settlements, so it would accelerate settlements; even as this ban discourages postfiling settlements, it would encourage prefiling settlements.

- Accelerating settlements would have mixed effects: earlier settlements save more litigation costs; on the other hand, settling too early may mean less accurate liability estimates; on the third hand, parties likely settle too late now, so earlier settlements may still be advantageous.

- A confidentiality ban's effects would vary among high- and low-value cases, but it is difficult to predict which type would be more affected.

- More settlement disclosure could induce more lawsuits, both good and bad, but by decreasing litigation uncertainty, it also could discourage frivolous litigation and help parties to litigation settle their own cases.

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174. Stephen M. Johnson, *Junking the "Junk Science" Law: Reforming the Information Quality Act*, 58 ADMIN. L. REV. 37, 51 (2006) ("Businesses benefit from information disclosure programs because compliance costs . . . are much lower than costs for command and control laws."). Mandatory disclosure laws have drawn criticism, however, especially in fields like securities that some deem over-regulated with disclosure rules. *See, e.g.,* Peter Huang, Beyond Cost-Benefit Analysis in Financial Regulation: Emotional Impact Analysis 59–61 (June 30, 2006) (unpublished manuscript, on file with author), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=870453 (collecting criticisms of mandatory securities disclosure laws). Mandatory disclosure of settlements would not seem to risk that sort of over-regulation, however, because settlement disclosures would not be nearly as complicated, pervasive, or redundant as securities disclosures; settlement disclosure could be effectuated with the simple step of requiring the settlement agreement to be filed with the court, just like any other litigation document.

175. *See supra* Part II.

176. *See* BONE, *supra* note 27, at 15.

177. PHILIP K. DICK, I HOPE I SHALL ARRIVE SOON 4 (1985).

- More settlement disclosure could have positive effects beyond the con-
text of litigation, particularly in employment and product markets, by
helping employees, consumers, and investors who might otherwise en-
gage in "over-avoidance" distinguish the good from the bad in the
market.

Given these competing effects, economic analysis cannot offer a clear
prediction of the effects of banning confidentiality. With mere *prediction*
infeasible, economics certainly cannot make a meaningful *prescriptive*
judgment about whether a ban would be "good" or "bad."

While the economic view of settlement confidentiality is far more inde-
terminate than previously recognized, that does not mean economics is
useless in analyzing this difficult yet important issue. To the contrary, the
above list of tradeoffs and competing effects should be quite useful to poli-
cymakers, such as legislatures or panels of judges debating the issue.
Perhaps one or another of the competing considerations is more of a policy
priority to policymakers. Moreover, while empirical analysis of the entire
issue is probably unfeasible, policymakers certainly could inform their deci-
sions by undertaking empirical studies of certain key sub-issues: At what
point in litigation do cases currently settle? Is settlement more likely, or
more quickly achieved, in fields of law featuring less uncertainty, such as
breach of contract cases?

Finally, to the extent that economics shows that a confidentiality ban
might be promising or might be harmful, that cloud of uncertainty supports
the idea of local experimentation within our federal system. Specific states
or federal judicial districts could serve as the proverbial "laboratories of
democracy,"[178] undertaking an experiment with banning confidentiality that
could shed light on its effects. A small number of such experiments are un-
derway, but all of them fall far short of a blanket ban on confidentiality.[179]

Thus, even if economics cannot provide the holy grail of clear, categori-
cal answers, we need not descend into the nihilism of philosophers who
declare that "one thing is in the least certain—that nothing certain exists."[180]
Economics can provide policy guidance, but contrary to the traditional view,
it should not be seen as a barrier to the recent proposals to ban or restrict
confidentiality[181]—proposals that may be advisable either for non-economic

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178.   *See, e.g.*, New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dis-
senting) ("It is one of the happy incidents of the federal system that a single courageous State may
. . . serve as a laboratory; and try novel social and economic experiments without risk to the rest of
the country.").

179.   *See supra* notes 8–11 and accompanying text.

180.   1 PLINY, NATURAL HISTORY bk. II, para. V, at 185 (H. Rackham trans., Harvard Univ.
Press 1938). Neither do we need to adopt the more disturbing remainder of Pliny's famous quote:
"[O]ne thing is in the least certain—that nothing certain exists, and that nothing is more pitiable, or
more presumptuous, than man!" *Id.*

181.   See Zitrin, *supra* note 10, at 889–97 (discussing proposals at various levels—federal law,
state law, federal judicial district local rules, and ethics authorities such as the American Bar Asso-
ciation—for restricting confidentiality).

reasons or as a worthwhile reform experiment that economics sees as holding both great potential and great risk.