ASSESSING THE EFFECTS OF A "LOSER PAYS" RULE ON THE AMERICAN LEGAL SYSTEM: AN ECONOMIC ANALYSIS AND PROPOSAL FOR REFORM[τ]

Marie Gryphon[*]

Although the American justice system is derided as expensive, capricious, and prone to abuse, Americans go to court more often—and more expensively—than any other people in the world.[1] The purpose of this paper is to explore the possibility of reducing the incidence of what I will call "abusive litigation" in the United States by replacing the so-called "American rule" requiring each party to a lawsuit to pay her own attorneys, win or lose, with a "loser pays rule," according to which the losing party to a civil suit must pay the winner's reasonably incurred legal fees. Loser pays is the default rule for

[1] *See* TOWERS PERRIN TILLINGHAST, U.S. TORT COSTS AND CROSS-BORDER PERSPECTIVES: 2005 UPDATE 4 (2005), *available at* http://www.towersperrin.com/tillinghast/publications/reports/2005_Tort_Cost/2005_Tort.pdf.

payment of attorney's fees in the vast majority of foreign legal systems. [2]

While all litigation is costly, litigation of meritorious claims is sometimes necessary in order to compensate damaged victims or parties to broken contracts. Abusive litigation, by definition, is not even close to being legally meritorious.[3] Rather, it is pursued by a plaintiff or attorney who has good reason to believe that she is legally in the wrong, but who sues anyway in order to exact revenge or coerce a settlement from the lawsuit's target. The American rule makes the civil justice system as a whole unnecessarily costly by encouraging the filing of such lawsuits, which defendants must either settle quickly or defend against at significant cost. Such low-merit legal cases clog the American legal system and raise the cost of goods and services to consumers by forcing businesses that are sued to cover their legal expenses by raising prices.

The American rule also makes most legal victories Pyrrhic ones. As Professor Jon Langbein told ABC's John Stossel, "When you win, you lose under our system. I win, I defeat your claim . . . but it has cost me tens, hundreds of thousands, sometimes millions of dollars. I have a victory that has brought me to the poorhouse."[4] Our present system is as unfair to a deserving plaintiff as it is to a blameless defendant. In theory, a negligent defendant must "make whole" an injured plaintiff by restoring him as nearly as possible to his position before the injury occurred. In reality, American contingent fees are usually one-third of any recovery,[5] and litigation costs paid by the

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[2] *See generally* W. Kent Davis, *The International View of Attorney Fees in Civil Suits: Why is the United States the "Odd Man Out" in How It Pays Its Lawyers?*, 16 ARIZ. J. INT'L & COMP. L. 361 (1999).

[3] I intentionally avoid the term "frivolous" because it has a legal meaning; it refers to the standard under which a court may sanction litigants under Rule 11 of the Federal Rules of Civil Procedure and state law counterparts to Rule 11. *See* FED. R. CIV. P. 11. Not all abusive lawsuits are frivolous in this sense. To avoid confusion, this paper will not refer to suits as "frivolous" outside of the context of Rule 11.

[4] *ABC News Special: The Trouble with Lawyers* (ABC television broadcast Jan. 2, 1996).

[5] HERBERT M. KRITZER, RISKS, REPUTATIONS, AND REWARDS: CONTINGENCY FEE LEGAL PRACTICE IN THE UNITED STATES 39 tbl.2.4 (2004).

plaintiff may soak up a substantial additional percentage of any judgment or settlement.[6] Also, potential plaintiffs with injuries that are significant but worth less than their lawyers' fees can be denied access to justice entirely.

Despite these defects, the American rule has many defenders, who argue that the costs of the current system are exaggerated and that adopting a loser pays rule would replace current injustices and inefficiencies with graver ones. Primary among the concerns of these scholars and commentators is the worry that injured parties might be unwilling to run even a small risk of incurring liability for ruinous attorneys' fees.[7] Even those not so deterred, this argument goes, could still be induced by veteran defendants to settle for far less than their claim is worth.[8]   Such objections are serious and deserve careful attention from reformers who wish to promote a more just and efficient legal order. Loser pays would not be an improvement over the current system if middle-class plaintiffs with strong legal claims became fearful of seeking justice. The case for a loser pays depends on its advocates honestly and convincingly addressing this concern, as this article does extensively in Part IV.

Any analysis of a legal reform proposal should begin with a clear statement of the features we want our justice system to have, and it should then evaluate the proposal in light of those features. A viable reform should advance broadly attractive goals, not merely contentious ideological commitments or narrow partisan interests. While the substantive law allocates benefits and burdens that are exogenous to the litigation process, some procedural rules, like those concerning attorneys' fees, allocate the transaction costs of seeking justice, including exposure to risk. What can we all agree that we want from these

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[6] WALTER K. OLSON, THE LITIGATION EXPLOSION 44 (1991).

[7] *See generally* Deborah L. Rhode, *Too Much Law, Too Little Justice: Too Much Rhetoric, Too Little Reform*, 11 GEO. J. LEGAL ETHICS 989, 1005 (1998).

[8] John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 AM. U. L. REV. 1567, 1609-10 (1993). *See generally* Rhode, *supra* note 7.

rules? This author believes that the following five goals reflect widely shared values about how these rules ought to function.

First, procedural reforms should have the effect of promoting compliance with the law, or at least should not discourage compliance. Although the justice of specific substantive laws might be debatable, if a body of law is generally just, the premise that procedural rules should promote legal compliance should be uncontroversial.

Second, victims should be fully compensated. All else being equal, a legal procedure is preferable to the extent that wrongfully injured victims are returned as nearly as possible to their uninjured states. We may disagree about how costly such reparation must become before it becomes unduly punitive, but this paper will assume that full compensation for wrongful injuries is generally a desirable goal of procedural reform.

Third, all else being equal, transaction costs should be as low as possible. If a given procedure can enforce the law and compensate victims as well as or better than a different procedure, and do so at less cost, then it should be adopted and the alternative rejected.

Fourth, the transaction costs associated with litigation should not be allocated to a legally innocent party if otherwise reasonable alternatives are available. In general, a system that imposes heavy costs on a defendant who is not liable is inferior to one that does not do so. By the same token, a system that imposes heavy costs on a deserving plaintiff is inferior to a system that does not. There may be good public policy reasons to subsidize plaintiffs who bring some kinds of losing cases. In such instances, the cost of those subsidies is better shared by the society that benefits from the existence of a system of civil justice rather than concentrated on an individual innocent party.

Fifth, procedural rules should not discourage parties with strong legal claims from pursuing justice. In particular, different parties have different levels of risk aversion, and procedural rules should not have the effect of barring the courthouse door to risk-averse parties with good cases.

This paper will evaluate the American rule and a loser pays reform proposal on the basis of how well they serve these five broadly attractive criteria. If the loser pays reform proposal is superior to the American rule on these grounds, it ought to command broad support. Part I of this paper describes the

current state of the legal marketplace and how some of its participants profit from abusing it. Part II summarizes the best theoretical research into what kinds of effects we could expect loser pays to have on litigation. Part III builds on the hypotheses developed in Part II by examining evidence from two important loser pays experiments here in America. Part IV explores the possibility of preserving access to justice for plaintiffs with reasonably strong lawsuits through a system of litigation insurance. Part V offers a specific loser pays reform proposal and guidelines for its implementation.

PART I: THE STATUS QUO

Reporting on abusive litigation tends to focus on the most outrageous claims, often involving enormous claims for damages, such as a recent $54 million lawsuit that Washington, D.C. Administrative Judge Roy Pearson filed against his local dry cleaner for allegedly losing a pair of slacks.[9] The media also report on cases in which plaintiffs are awarded large sums for injuries they suffered after assuming commonly understood risks, as was situation with the plaintiff who was scalded when she spilled a hot cup of McDonald's coffee.[10] Other kinds of suits that get major press attention are typically class actions or government-led claims that target companies for selling popular but arguably unhealthy products, such as high-calorie foods or violent video games.

Such cases get media attention because they involve particularly bizarre facts, colorful characters, or millions of dollars, or because they potentially affect our lives. But abusive lawsuits that are not so lurid or absurd are not unusual. Most of them cost the individual defendants little; but collectively, they drive up the prices that we pay for groceries, automobiles, health

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[9] Marc Fisher, *Judge Who Seeks Millions for Lost Pants Has His (Emotional) Day in Court*, WASH. POST, June 13, 2007, at B1. Studies have indicated that 65-85% of jury-eligible people in the United States believe that there are too many frivolous lawsuits filed. Richard Waites & Jim Lawrence, *Juror Perceptions About Lawsuits and Tort Reform*, THE ADVOCATES, 2, http://www.theadvocates.com/Juror%20Perceptions%20About%20Lawsuits%20and%20Tort%20Reform.pdf (last visited Apr. 5, 2011).

[10] KRITZER, *supra* note 5, at 2.

care, and other goods and services. This section will describe how the legal marketplace currently works, why abusive lawsuits are filed, and how the lawyers who file them make a living.

Lawsuits vary in the amount of money they seek, the complexity of the underlying facts (which often determines how many hours a lawyer must spend on a case), and the merits of the case (defined here as the likelihood that the plaintiff will win at trial).
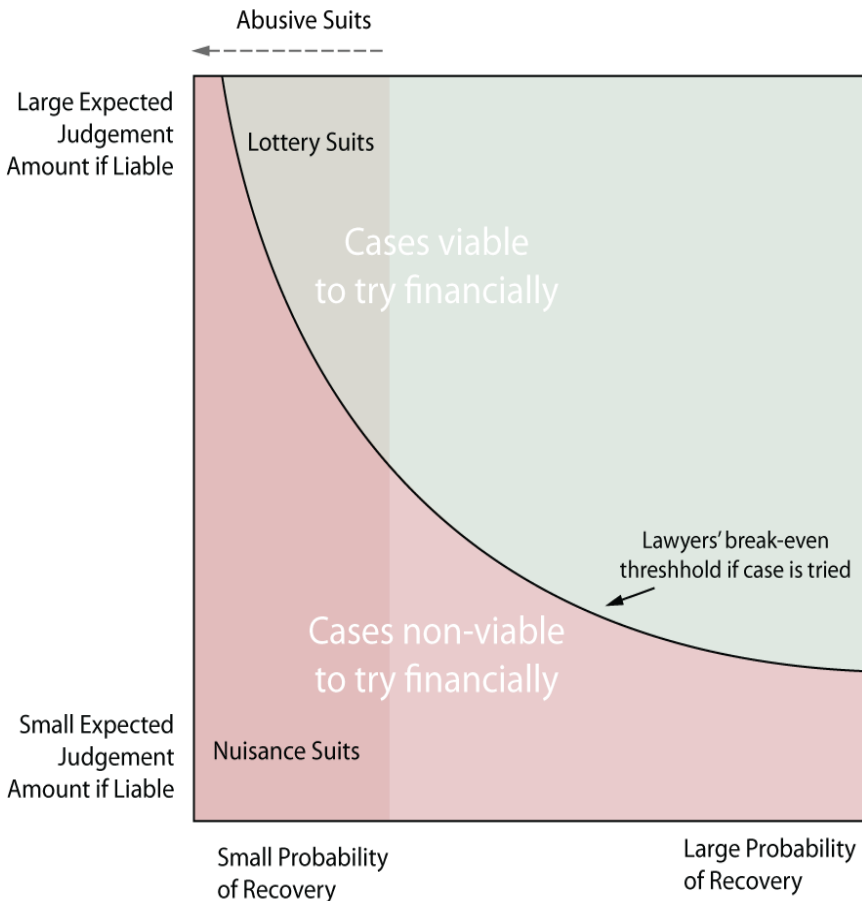
Figure 1

Figure 1 depicts the litigation universe in two dimensions by holding the number of hours worked constant. The curved line represents a contingent-fee lawyer's financial break-even point (or "opportunity cost") for a given case, assuming that it goes to trial. The higher the financial stakes of a particular case are, the

lower the legal merit of the case needs to be in order to give a lawyer an economic incentive to file it. A case brought by a severely injured plaintiff against a defendant who is very unlikely to be responsible for her injuries, for example, would be located in the upper left corner of the figure. The most profitable cases, featuring both high financial stakes and high legal merit, are located at the top right corner of the figure.

"Abusive lawsuits"—represented by the shaded area in Figure 1—have little legal merit, regardless of the magnitude of the recovery sought. "Lottery suits," as the term will be used herein, are defined by a combination of low legal merit and very high stakes. Many of these cases meet or exceed a lawyer's break-even threshold for trials not because they have merit but because there is so much money at stake that a contingent-fee lawyer can make a living by "hitting the jackpot" in only a small minority of these cases.

Professor Herbert Kritzer of the University of Wisconsin Law School describes the practices of three lawyers whose behavior can be plotted on Figure 1: "Brown handles mostly larger cases involving significant damages; he prides himself on taking and winning large recoveries in cases that other firms decline as too risky. Adams and Clarke handle a lot of very routine cases, most of which would not be economical to take to trial . . . ."[11] We can infer from Kritzer's description that Brown at least sometimes takes lottery suits. Adams and Clarke, on the other hand, handle primarily cases below the "break-even" line on Figure 1 for trials—that is, Adams and Clarke would lose money on these cases if forced to litigate them. Some of these cases will be the kinds of small, meritorious claims found in the bottom right-hand corner of Figure 1. Others are likely to be "nuisance suits," a term which will be used herein to refer to lawsuits characterized by modest stakes and little legal merit.[12] Such

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[11] *Id.* at 98.

[12] Professor Kritzer argued recently in an online forum that most nuisance suits in his data set featured weak evidence of causation rather than weak evidence of a breach of a duty of care. *See* Rebecca Love Kourlis, *Would "Loser Pays" Eliminate Frivolous Lawsuits and Defenses?*, NEW TALK (Aug. 19-20, 2008),   http://newtalk.org/2008/08/would-loser-pays-eliminate-fri.php (online discussion). For the purpose of this analysis, these weaknesses are interchangeable: both are features of a suit with little legal merit, filed solely for settlement value.

suits, located in the bottom left-hand corner of Figure 1, are filed for the sole purpose of inducing a defendant to settle them in order to avoid the expense of going to trial. Nuisance suits, by this definition, fall below any contingent-fee lawyer's break-even threshold for taking a case to trial. Therefore, such cases must be settled early in order to be lucrative enough for the lawyers who file them. This paper will explore the possibility that loser pays reforms can reduce or eliminate abusive lawsuits, especially nuisance suits.

PART II: WHO FILES NUISANCE SUITS?

We usually imagine that nuisance suits are filed by struggling lawyers operating alone or in a small firm, "chasing ambulances," or otherwise aggressively marketing their services to disoriented or hesitant clients. We don't think of them as being filed by the kinds of lawyers who labor at complex, multiyear disputes in elite downtown offices. Economists Eyal Zamir and Ilana Ritov offer a model of the legal marketplace that suggests that these stereotypes are largely correct: there is a clear pecking order among plaintiffs' lawyers.[13]

Contingent fees are fairly uniform within a given geographic area: most plaintiffs' lawyers charge a percentage of a recovery in any case they take—usually about 33 percent, though in some jurisdictions the going rate is higher.[14] Zamir and Ritov show that standard pricing of contingent-fee legal services is possible in part because simple, strong cases afford lawyers higher effective hourly rates than do complex, weak cases even if the nominal contingent fee is identical.[15] As a result, successful

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[13] *See generally* Eyal Zamir & Ilana Ritov, *Neither Saints Nor Devils: A Behavioral Analysis of Attorneys' Contingent Fees*, SOCIAL SCIENCE RESEARCH NETWORK (Jan. 22, 2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1085985.

[14] Lester Brickman, *The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?*, 25 CARDOZO L. REV. 65, 78 (2003). *See also* KRITZER, *supra* note 5, at 38-40 (reporting that a majority of plaintiffs' lawyers surveyed charged a one-third contingent fee). Kritzer disagrees that his finding suggests that fees are fairly uniform. *See id.*

[15] Zamir & Ritov, *supra* note 13, at 6-7.

lawyers (who can be extremely selective about the cases they take) accept only those cases that can produce very high effective hourly compensation: "[T]he standard rate endures in the market thanks to a process of assortative matching, that is, the process through which plaintiffs with very strong cases contract with the very best lawyers, second-best cases are handled by second-best attorneys, and so forth."[16]

Indeed, most plaintiffs' lawyers decline most of the cases offered them, and the rate at which the most successful of them turn down cases is far above the average.[17] There is also evidence that an elite subset of lawyers is able to attain exceptionally high effective hourly rates through careful selection of cases.[18] Figure 2 illustrates how, according to Zamir and Ritov, cases and lawyers are matched.

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[16] *Id.*

[17] KRITZER, *supra* note 5, at 76.

[18] *Id.* at 75-76.

Figure 2
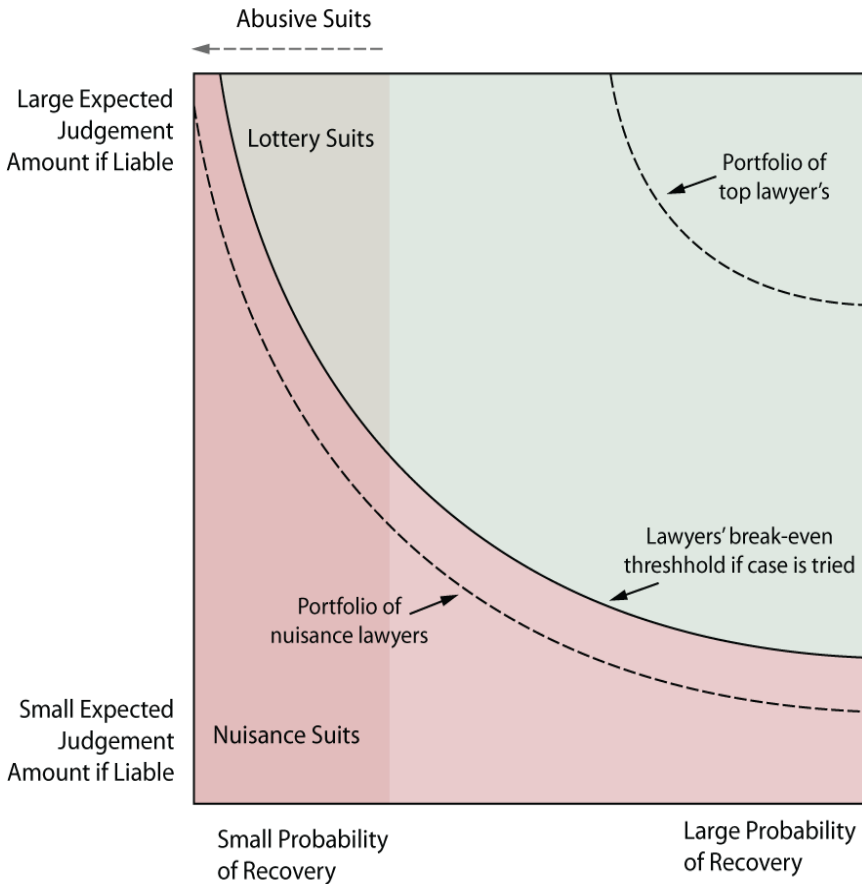
The dotted line in the top right corner of Figure 2 delineates a portfolio of highly lucrative cases that would be representative of a top plaintiffs' lawyer. The Zamir-Ritov model implies that, just as there is an upper echelon within the ranks of plaintiffs' lawyers, there is also a lower echelon, whose portfolio is defined by the curved series of dashes in the bottom left section of Figure 2. Such "nuisance lawyers" can attract only the weakest cases. Kritzer describes the investment strategy that such a lawyer can be expected to adopt: "[T]he lawyer can be relatively nonselective. Under this approach, the lawyer may want to minimize the investment in most cases. The goal is to achieve lots of small recoveries, with relatively little investment."[19]

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[19] *Id.* at 15.

The most notable exceptions to the rule that only struggling lawyers file dubious suits are low-merit mass torts and class action suits, which attract elite lawyers because they offer enormous efficiencies of scale. [20]   These kinds of cases concern hundreds or thousands of similarly injured plaintiffs and are usually settled en masse.[21]   Because they require lawyers to spend little or no time on any individual claimant, they can be very profitable for lawyers even if each individual case would have little value on its own.[22]

HOW DO NUISANCE LAWYERS REMAIN IN BUSINESS?

Experts have struggled to explain how a lawyer can make money by filing lawsuits that cost more money to try than the lawyer can hope to recover in fees. If the defendant knows that the cost to the plaintiff of taking the case to trial is sure to exceed the amount he can recover, it seems to follow that the defendant will refuse to settle, knowing that the plaintiff is likely to drop the case.

Nonetheless, nuisance suits often culminate in a settlement offer from a defendant. Economists David Rosenberg and Steven Shavell have shown that a defendant will settle a nuisance suit if the cost of filing an initial response to a complaint is significant, since the cost of replying itself makes settlement attractive.[23]   Even for cases in which the initial response is not prohibitively expensive, a defendant may not be able to tell whether a particular suit is a nuisance suit, according

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[20] *See* RICHARD A. NAGAREDA, MASS TORTS IN A WORLD OF SETTLEMENT ix (2007) ("One significant facet of the mass tort phenomenon consists of the emergence and operation of an elite segment of the personal injury plaintiffs' bar.").

[21] *See id.* at 9.

[22] *See* R.A. Nagareda, *Embedded Aggregation in Civil Litigation,* 95 CORNELL L. REV. 1105, 1154-55 (2010).

[23] D. Rosenberg & S. Shavell, *A Model in Which Suits are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3 (1985).

to lawyer and economist Lucian Bebchuk.[24] For certain types of claims, like mass torts, this explanation seems particularly compelling: the transaction costs of sifting through thousands of claims to separate the good cases from the bad can exceed the cost to settle each claim.

Paradoxically, plaintiffs' lawyers who file nuisance suits are also helped by ethics rules that prohibit them from withdrawing from cases if doing so would impose a substantial hardship on a client.[25] While the Model Rules of Professional Conduct nominally permit lawyers to withdraw from representing a client if continued representation creates an "unreasonable financial burden" on the lawyer,[26] case law overwhelmingly holds that a client's refusal of an offer of settlement does not justify withdrawal under this provision.[27] These ethical constraints enable a plaintiff's lawyer to credibly commit in advance to trying any case that he files on behalf of a client if it is not first settled.

Bebchuk and Andrew Guzman have shown that contingent-fee arrangements enhance the pretrial bargaining power of plaintiffs themselves by insulating them from almost all the considerable marginal costs of going to trial, which are borne by the contingent-fee attorney and, of course, the defendant.[28] Plaintiffs' bargaining power would not be enhanced in this way if plaintiffs' lawyers were free to drop cases that do not settle.

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[24] *See generally* Lucian Arye Bebchuk, *Litigation and Settlement Under Imperfect Information*, 15 RAND J. ECON. 404 (1984).

[25] *See* MODEL RULES OF PROF'L CONDUCT R. 1.16(b)(1) (2009).

[26] *See* MODEL RULES OF PROF'L CONDUCT R. 1.16(b)(6) (2009).

[27] *See* H.M. Erichson & B.C. Zipursky, *Consent Versus Closure*, 96 CORNELL L. REV. 265, 287-89 (2011).

[28] Lucian Arye Bebchuk & Andrew T. Guzman, *How Would You Like to Pay for That? The Strategic Effects of Fee Arrangements on Settlement Terms*, 1 HARV. NEGOTIATION L. REV. 53, 54 (1996). Kritzer's survey of contingent-fee lawyers practicing in Wisconsin indicates that lawyers make far less money per hour on cases that are tried than they do on cases that are settled. *See* KRITZER, *supra* note 5 tbl.6.2a, 6.2b.

Still, if a distinct class of lawyers is responsible for most nuisance litigation, as Zamir and Ritov's research implies, it might seem as though defendants could just identify those lawyers and systematically refuse to settle the cases that they file, at least in cases that do not demand an unusually costly initial response or whose outcome is not highly uncertain. Presumably, the lawyers so targeted would stop filing nuisance cases, since they would not be lucrative enough to justify the cost of going to trial.

That defendants have not adopted this strategy on any large scale is explained by a collective-action problem: it is impossible for all frequently-sued individuals and businesses to commit to each other that they will litigate every suit filed by a designated nuisance lawyer. In any individual case, a defendant is motivated to settle early because she knows that, if she holds out, the platintiff's lawyers will be financially sustained by settlement proceeds from other defendants who have settled, and will settle, other cases, and will therefore be able to continue to press their claim against her.

Defendants' incentive to settle nuisance cases—even those from lawyers who habitually file them—is a version of a classic decision problem that game theorists call the "Stag/Hare game."[29] Figure 3 illustrates the Stag/Hare game in the context of two defendants who must decide whether to settle or litigate nuisance suits. Each of the four boxes represents a possible outcome for the defendants depending on the decisions they both make. Defendant 1's outcomes ("best," "middle," or "worst") appear first in each box, while Defendant 2's outcomes appear second.

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[29] In the original Stag/Hare game, two hunters must decide whether to pursue a stag or a hare. Killing a stag requires the commitment of both hunters and produces the most meat for each participant. However, because each hunter can't count on the other to pursue a stag also, the hunters usually decide to pursue hares, which can be killed independently, even though they are less filling. *See* DOUGLAS G. BAIRD, ROBERT H. GERTNER & RANDAL C. PICKER, GAME THEORY AND THE LAW 35-36 (1994).

Figure 3

If all defendants take nuisance suits from a particular nuisance lawyer to trial, they will drive that lawyer out of business. This is the best outcome for the defendants, represented by the upper left-hand box in Figure 3. But if some defendants settle, those who do not settle will incur trial expenses unnecessarily. This is the worst outcome, represented by the upper right-hand box for Defendant 1 and by the lower left-hand box for Defendant 2. If either defendant fears that the other will sometimes settle, either due to risk aversion or by strategic mistake, then she will also adopt a strategy of settlement. As a result, defendants generally find themselves participating in a pervasive culture of settlement, even when the suits settled are extremely weak. This outcome, represented by the lower, right-hand box in Figure 3, is the only stable equilibrium in the game.[30]

Indeed, the empirical literature shows that the United States has developed a culture of nearly universal settlement.[31] Only

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[30] *See id.* at 36. In economists' parlance, there are two Nash equilibriums in this game: [litigate, litigate] and [settle, settle]. *See id.* However, [litigate, litigate] is not "trembling hand perfect." SHAUN H. HEAP, YANIS VAROUFAKIS, GAME THEORY: A CRITICAL INTRODUCTION 68-70 (1995). Therefore, universal litigation is not a stable equilibrium in this game if the players occasionally make errors. Only [settle, settle] survives dominance refinement analysis and is the expected equilibrium in this game.

[31] *See* KRITZER, *supra* note 5, at 177.

about 7 to 9 percent of lawsuits filed actually proceed to trial.[32] Lawyers and policymakers praise high settlement rates because settlement avoids the public and private expenses of a trial. It is nonetheless worth noting that many low-merit lawsuits could be deterred if it were possible for defendants to commit in advance to taking them to trial.

PART III: WHAT TO EXPECT FROM LOSER PAYS

While researchers differ on what some of the effects of a loser pays rule might be—and certainly differ on the overall advisability of adopting one—there is broad consensus that a loser pays rule would reduce the number of nuisance suits.[33] This reduction would occur because defendants would be willing to pay much less to settle low-merit suits under loser pays than they currently do.

A simple example will illustrate why a defendant would insist on paying less to settle a nuisance suit under loser pays. Suppose a plaintiff has suffered a loss of $10,000 (an amount that is not in controversy in this example), but his suit has little legal merit because the defendant probably did not cause his injury, giving the plaintiff only a 20 percent chance of winning at trial. Suppose that the plaintiff's lawyer (who is working under a contingent-fee agreement for 33 percent of any recovery) and the defendant would each have to invest $5,000 worth of legal services in order to try the case. The plaintiff's

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[32] *See* David M. Trubek et al., *The Costs of Ordinary Litigation*, 31 UCLA L. REV. 72, 89 (1983); Kevin McCabe & Laura Inglis, *Using Neuroeconomics Experiments to Study Tort Reform*, MERCATUS POL'Y SERIES, Nov. 2007, at 12, *available   at* http://mercatus.org/sites/default/files/publication/20080104_Tort_Final.pdf.

[33] For the seminal early work suggesting that a loser pays rule reduces the number of frivolous suits filed, *see* Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55, 59-60 (1982). *See also* GORDON TULLOCK, TRIALS ON TRIAL: THE PURE THEORY OF LEGAL PROCEDURE 17, 65-67 (1980); Lucian Arye Bebchuk, *A New Theory Concerning the Credibility and Success of Threats to Sue*, 25 J. LEGAL STUD. 1, 19-20 (1996); McCabe & Inglis, *supra* note 32, at 17-18. *But cf.* Ronald Braeutigam, Bruce Owen & John Panzar, *An Economic Analysis of Alternative Fee Shifting Systems*, 47 LAW & CONTEMP. PROBS. 173, 181-82 (1984) (results ambiguous).

lawyer could expect a fee of only $667, since 20 percent of $10,000 is $2,000, and 33 percent of $2,000 is $667, for $5,000 worth of work if the case goes to trial.

The plaintiff's lawyer, therefore, plans to settle the case. Under the American rule, he may extract between $2,000 and $7,000 from the defendant in settlement, because the defendant knows that it will have to spend $5,000 on unrecoverable legal costs if it fails to settle and because the case has an additional expected value of $2,000 for the plaintiff.

Under loser pays, however, defendants would either refuse to settle or would offer far less in settlement. In our example, the defendant has an expected cost of going to trial of only $3,667 under a loser pays rule, reflecting its 20 percent chance of losing the case and paying damages and both parties' legal fees.[34] Therefore, the defendant would never pay more than $3,667 to settle this case—just over half of the maximum of $7,000 that a plaintiff could extract from the same suit under the current system. Because loser pays would make nuisance suits less valuable, the effective hourly rates of nuisance lawyers would decline. In the face of reduced earnings, some nuisance lawyers would surely choose to file different kinds of cases (such as meritorious small claims), or they would migrate to other specialties or careers.

Loser pays would also have some impact on the settlement prospects of mass-tort claims by deterring some of the thousands of low-merit individual claims that are based on more or less the same facts. Under the American rule, mass-tort lawyers have an incentive to recruit thousands of plaintiffs with dubious claims, since they know that the cost to defendants of ferreting out the weak or even fraudulent cases and taking them to trial is prohibitively high. Under loser pays, mass-tort lawyers would be less able to force settlements by pointing to the enormous transaction costs of conducting thousands of individual trials. Without this leverage, mass-tort lawyers would have less incentive to include weak claims in their portfolios. Loser pays would also reduce the number of low-

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[34] This example assumes that the plaintiff's attorney would recover only his contracted-for fees. If instead the plaintiff's attorney could recover his actual incurred cost of $5,000, the analysis would not change materially: the expected cost to the defendant would be $4,000, still $3,000 less than under the American rule.

merit class action lawsuits, but not to the extent that it would individual cases, in which legal fees and expenses are bound to be a higher proportion of a defendant's total exposure.
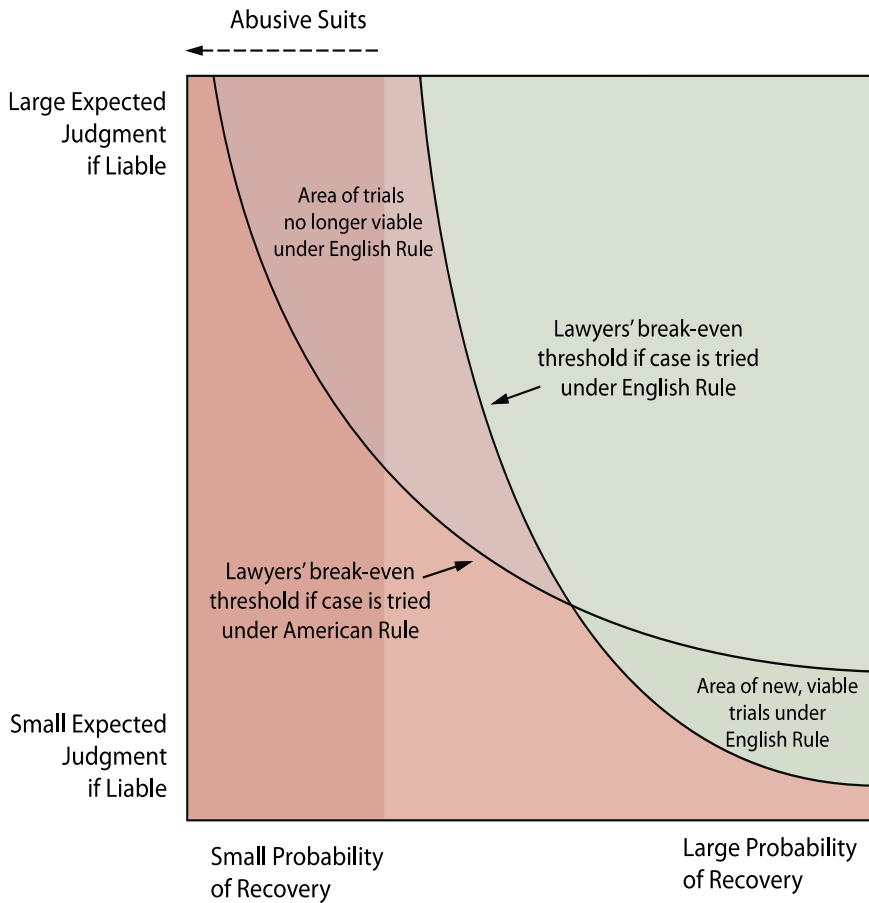
MORE MERITORIOUS SMALL CLAIMS

In addition to reducing the number of nuisance suits, most researchers agree that a loser pays rule would make viable some small, highly meritorious lawsuits that cannot be profitably tried in the current system.[35] Figure 4 shows how a loser pays rule would shift the break-even line for suits taken to trial and therefore, by inference, the viability of all meritorious suits, including those that settle.[36]

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[35] *See* TULLOCK, *supra* note 33, at 65-67; Lucian Arye Bebchuk, A New Theory Concerning the Credibility and Success of Threats to Sue, 25 J. LEGAL STUD. 1, 19-20 (1996) (demonstrating mathematically that plaintiff negotiating power is enhanced for suits with a greater than 50% chance of prevailing at trial); Keith N. Hylton, *Litigation Cost Allocation Rules and Compliance with the Negligence Standard*, 22 J. LEGAL STUD. 457, 464-66 (1993); Avery Katz, *Measuring the Demand for Litigation: Is the English Rule Really Cheaper?*, 3 J.L. ECON. & ORG. 143, 156-57 (1987); Shavell, *supra* note 33, at 59-62; Edward A. Snyder & James W. Hughes, *The English Rule for Allocating Legal Costs: Evidence Confronts Theory*, 6 J.L. ECON. & ORG. 345, 349 (1990).

[36] The break-even line for all suits, including those that settle, would shift in tandem with the break-even line for suits reaching trial. This means that what are now "nuisance lawyers" would have to seek higher-merit cases under loser pays in order to maintain their current levels of compensation even if their cases continue to settle at similar rates.

Figure 4

Abusive Suits

Large Expected
Judgment
if Liable

Area of trials
no longer viable
under English Rule

Lawyers' break-even
threshold if case is tried
under English Rule

Lawyers' break-even
threshold if case is tried
under American Rule

Area of new, viable
trials under
English Rule

Small Expected
Judgment
if Liable

Small Probability
of Recovery

Large Probability
of Recovery

    The increased viability of small, meritorious claims would
have both benefits and costs. On one hand, a person with a
modest but meritorious claim deserves compensation, and more
complete compensation for victims is one of the most important
ways in which a loser pays rule could make the U.S. legal system
more just. Critics of loser pays who worry that the rule would
limit access to the courts often fail to acknowledge that the
American rule bars court access for small but strong claims of
injury, unless the claims can be grouped into a class action. On
the other hand, a significant influx of small, meritorious claims
under loser pays might keep the overall amount of litigation,
and thus the overall cost of the civil justice system, from
decreasing as a result of reform.

Fortunately, there are reasons to think that the reduction in nuisance suits following the adoption of loser pays would be greater than the increase in small, highly meritorious lawsuits. While it is true that many such claims are too small to be worth taking to trial under the current system, many nuisance claims are small as well. Yet nuisance claims of this kind are filed, anyway, for their settlement value—just as are, undoubtedly, substantial numbers of meritorious claims that are not too insignificant to be worth pursuing to trial. Also, many small claims are currently litigated as class actions.

Responses from Kritzer's survey of contingent-fee lawyers in Wisconsin also suggest that more nuisance suits would be deterred under a loser pays rule than the number of new, highly meritorious claims filed as a result of the adoption of loser pays.[37] Figure 5 shows the relative frequency of various reasons that contingent fee lawyers give when they decide to decline a case.[38] Surveyed plaintiff's lawyers named only a lack of legal liability as their reason for declining 47 percent of the cases they turned down, and they named both a lack of legal liability and a lack of adequate damages as a reason for declining another 13 percent of rejected cases.[39] Only 19 percent of rejected cases were declined for the sole reason that the expected size of the recovery was too low.[40]
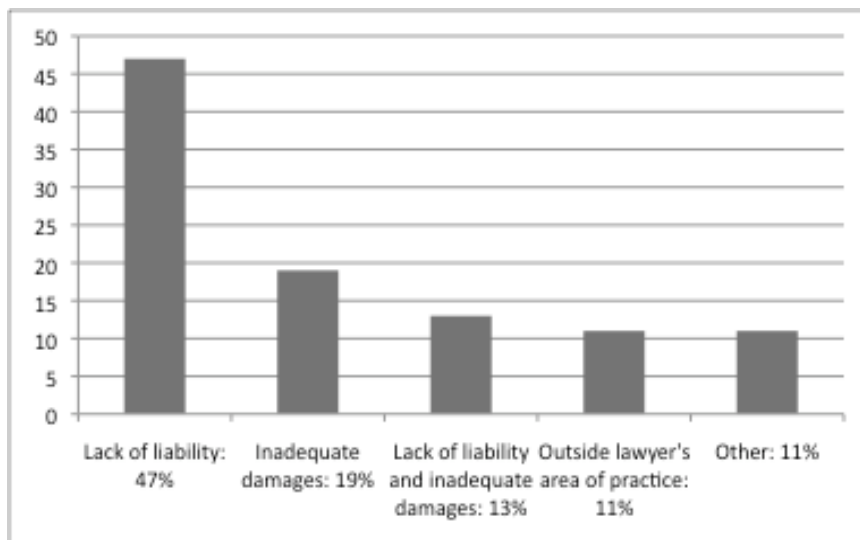
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[37] *See* Kritzer, *supra* note 5, at tbl.3.9.

[38] *Id.*

[39] *Id.*

[40] *Id.*

Figure 5

These responses (combined with statistical principles) imply that of all the cases that lawyers are asked to pursue—*on either side of their accept/reject threshold*—a greater number have marginal legal merit than have merit but promise only marginally-sized recoveries.[41] If that is so, the number of low-merit cases that loser pays would discourage should be larger than the number of small, high-merit cases that loser pays encourages.

High-merit, low-damages injuries are also unlikely to be litigated to trial under loser pays because defendants would have no financial incentive to resist compensating those they have genuinely harmed.   Loser pays should therefore promote immediate, appropriate, handling of small injuries in order to avoid litigation. Under the American rule, defendants are likely to treat small, high-merit claims just like nuisance claims and under-compensate genuinely injured victims.[42] Plaintiffs with small, good claims deserve more prompt and generous

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[41] Perhaps this is the case because plaintiffs know whether they are injured but lack the specialized knowledge to know whether they are legally in the right.

[42] Potential class actions are, of course, an exception to this rule.

compensation than they currently get, and loser pays would incentivize defendants to provide this immediately.

SETTLEMENT RATES

Research is deeply split on the issue of whether a loser pays rule would increase or decrease the rate at which lawsuits are settled rather than tried.[43] Loser pays, by increasing the amount of money in dispute in any given case (that is, by "raising the stakes" of litigation), may reduce settlement rates by magnifying differences of opinion between the parties about what each is likely to gain by going to trial.[44] On the other hand, higher stakes could induce risk-averse parties to settle.[45] Experiments designed to predict the effect that a loser pays rule would have on settlement rates have yielded mixed results. Economists Kevin McCabe and Laura Inglis found that loser pays would lower rates of settlement,[46] while two older experiments suggest that settlement rates would increase.[47]

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[43] Some studies suggest that a loser pays rule will raise settlement rates. *See, e.g.,* Michael R. Baye, Dan Kovenock & Casper D. de Vries, *Comparative Analysis of Litigation Systems: An Auction-Theoretic Approach*, 115 ECON. J. 583, 599 (2005) ("To the extent that America's reputation for being a litigious society is based on the sheer number of suits brought to trial, a movement toward the Continental or British system might reduce the number of suits and the strain on the court system.") (footnote omitted); Snyder & Hughes, s*upra* note 35, at 369. Other studies suggest that a loser pays rule would lower settlement rates. *See, e.g.,* Keith N. Hylton, *An Asymmetric-Information Model of Litigation*, 22 INT'L REV. L. & ECON. 153, 162 (2002) ("[T]he British rule, consistent with earlier analyses, generat[es] the most litigation."); McCabe & Inglis, *supra* note 32, at 18; Shavell, *supra* note 33, at 65-66.

[44] *See* Hylton, *supra* note 35, at 459.

[45] *See* Shavell, *supra* note 33, at 68.

[46] McCabe & Inglis, *supra* note 32, at 18.

[47] Don L. Coursey & Linda R. Stanley, *Pretrial Bargaining Behavior within the Shadow of the Law: Theory and Experimental Evidence*, 8 INT'L REV. L. & ECON., 161, 175-76 (1988); Peter J. Coughlan & Charles R. Plott, *An Experimental Analysis of the Structure of Legal Fees: American Rule vs. English Rule* 36 (Cal. Inst. of Tech. Div. of the Humanities & Soc. Scis., Working Paper No. 1025, 1997).

The question of the effect of loser pays on settlement rates, however, may not be as consequential as the extent of academic interest in the subject implies. Only about 8% of lawsuits filed go to trial now.[48]   The rest are resolved by settlement, by dismissal or summary judgment, or by the plaintiff's decision to drop the suit.[49]

In part because so few cases proceed to trial, most resources devoted to litigation are spent at its earlier stages, including settlement negotiations. Figure 6 is a breakdown of the time that litigation attorneys report spending on various activities related to the resolution of lawsuits. Because attorneys' fees are by far the largest cost of litigation, these figures are a reasonable proxy for overall legal costs. Importantly, litigation attorneys report that they spend only 8.6% of their time on hearings and trials.   Most of their time is devoted to activities that may precede serious settlement discussions: client interviews, case investigation, pretrial motions, and settlement negotiations. While an early settlement would avoid many of these expenses, a settlement on the eve of trial would avoid very few of them.

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[48] Trubek et al., *supra* note 32, at 89.

[49] *See id.*

Figure 6[50]
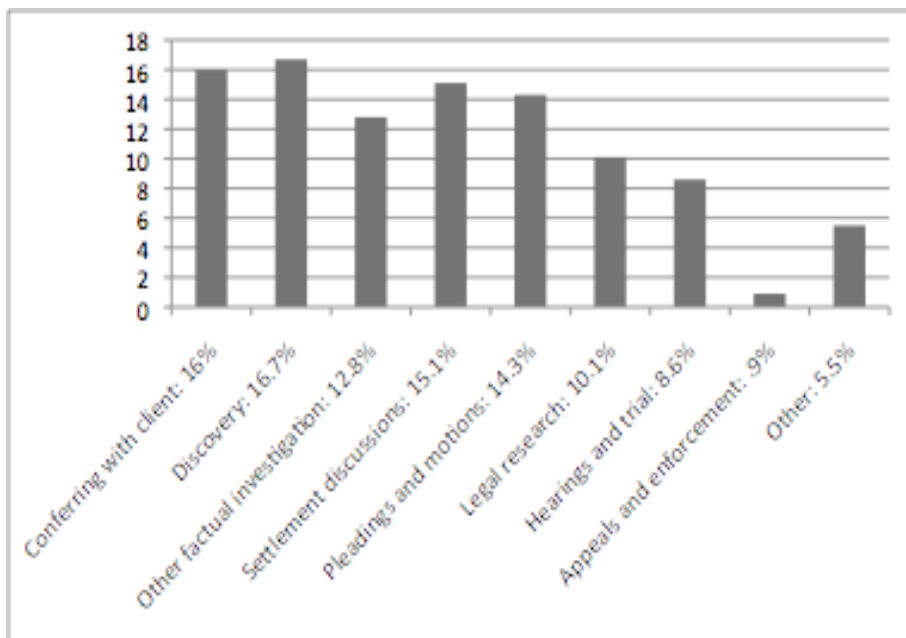
All else being equal, therefore, legal reforms that reduce filings are likely to reduce costs more than legal reforms that increase settlement rates, which are already very high. Still, a loser pays rule can and should be carefully designed not only to discourage low-merit filings but also to promote settlement.

LITIGATION COSTS PER CASE

Critics of loser pays warn that even if the rule should reduce the number of lawsuits filed, the cost of litigation per case may increase because each party no longer necessarily and exclusively bears its own costs.[51] Under a loser pays rule, each dollar of additional spending by either party is discounted by the probability that the other side would assume those costs upon

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[50] *Id.* at 91, tbl.3.

[51] *See* Baye, Kovenock & de Vries, *supra* note 43, at 599; Braeutigam, Owen & Panzar, *supra* note 33, at 180; Katz, *supra* note 35, at 144.

losing the case.[52] Whereas $1,000 in additional spending under an American rule would be borne wholly by the party making the decision to spend, a party under a loser pays regime that estimated its chance of winning at 50 percent would only bear $500 of the additional $1,000 spent.[53] Assuming that increased spending on legal services enhances a party's chances of prevailing, parties will spend more on legal services under loser pays, loser pays critics argue, than they would under a system employing the American rule.

This "cost-internalization" critique of loser pays is correct as applied to certain kinds of costs, but the charge that loser pays would increase overall costs per case is probably wrong in light of what we know about the kinds of costs that parties to litigation actually incur. The theoretical studies that predict increased per-case expenditures under loser pays assume that a litigant's choice to spend more on legal fees does not effectively require the opposing party to match those expenditures in response. If litigation spending induces responsive spending in equal or greater amounts by the opposing party, what economist Avery Katz calls a "provocative expenditure," then loser pays provides no incentive for the parties to run up these kinds of costs.[54] Katz argues that loser pays would increase trial expenditures, but his argument assumes that legal spending is not provocative.[55] He concedes that if it were, his concerns about loser pays would be misguided.[56]

Fortunately, empirical studies suggest that Katz's assumption about the character of most litigation spending is

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[52] Katz, *supra* note 35, at 160

[53] *Id.*

[54] *Id.* at 161 n.28.

[55] *See id.* at 160-61.

[56] *Id.* at 161 n.28 ("[I]f the opponent is somehow bound to respond in kind to marginal expenditure, and if the parties act strategically, so as to take advantage of this, as perhaps may be the case in civil discovery, the English rule may reduce incentives to engage in provocative expenditure."). Katz explains elsewhere: "For example, if the case were even, and the opponent were expected to react in kind to marginal expenditure on a dollar–for-dollar basis, the English rule might not reduce the marginal cost of expenditure." *Id.* at 172.

wrong. Most decisions to spend money on litigation *are* provocative because they trigger a litigation event, such as a motion, discovery request, or pretrial conference, which requires the opposing party to undertake a costly activity in response.[57] A leading empirical researcher who collects data on the legal system, Kritzer, seems to agree that litigation expenditures are mostly provocative in nature, though he opposes loser pays reforms.[58] He reports that lawyers' efforts in litigation are "largely determine[d]" by "the actions of the opposing party," and that "[e]ach decision to invest additional effort will then influence the defense side, which in turn may make investments that require further investment by the plaintiff's side."[59] Data from the Wisconsin Civil Litigation Research Project confirm that case complexity and associated litigation "events," not the sums at stake, are the main drivers of litigation spending—a result that is at odds with the hypothesis embraced by critics of loser pays that parties under such a regime will be motivated to spend more overall.[60]

In fact, the American rule may cause per-case litigation spending to be higher than it would be under loser pays because America has very liberal discovery rules, and discovery requests are a very provocative expenditure. Katz's own model suggests that the American rule actively encourages any expenditure so provocative that it requires a much larger expenditure from the opposing party in response.[61] This is true of discovery requests: they are far faster and easier to draft than they are to respond to. Plaintiffs' attorneys in the United States may currently choose to bury defendants in onerous discovery requests, knowing that their clients bear none of the costs of document production. As

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[57] See Trubek et al., *supra* note 32, at 102 tbl.8.

[58] KRITZER, *supra* note 5, at 17-18; Herbert M. Kritzer, *"Loser Pays" Doesn't*, LEGAL AFF., Nov./Dec. 2005, at 24 (opposing loser pays on the grounds that it would result in increased litigation costs).

[59] KRITZER, *supra* note 5, at 17-18.

[60] *See* Trubek et al., *supra* note 32, at 102 tbl.8 (indicating that "events" such as motions and discovery requests are the primary driver of costs in the typical case).

[61] KRITZER, *supra* note 5, at 17-18.

Figure 6 shows, lawyers report that discovery is one of the most time-consuming litigation activities they undertake, so these costs are substantial, and are inflated by the American rule. A loser pays rule would discourage excessive discovery in low-merit suits. It would also discourage defendants from the wasteful practice of filing standardized motions with little legal merit in order to require plaintiff's counsel to spend greater time and effort researching and drafting a response.

Thus, a close look at the prevalence of different kinds of spending done by parties to a lawsuit suggests that a loser pays rule probably would not increase overall per-case expenditures, and might even have the opposite effect. Nevertheless, critics' concern that loser pays rules would encourage higher spending remains well founded with respect to certain kinds of litigation costs and therefore should be addressed by reformers when they craft loser pays reform proposals.

COMPLIANCE EFFECT

The "compliance effect" is one of the most interesting and salutary results of a loser pays rule: potential defendants, facing the risk of having to pay a winning plaintiff's legal fees, can be expected to try harder to meet legal standards of care when they engage in business activities. In effect, loser pays makes legal compliance cheaper and legal culpability more expensive, motivating businesses and individuals to spend more money to ensure the blamelessness of their behavior.[62] Figure 7 is a decision tree that compares the differing incentives that potential defendants have under the American rule and under a loser pays rule to invest in preventative safety measures.

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[62] *See* Hylton, *supra* note 43, at 154.

Figure 7
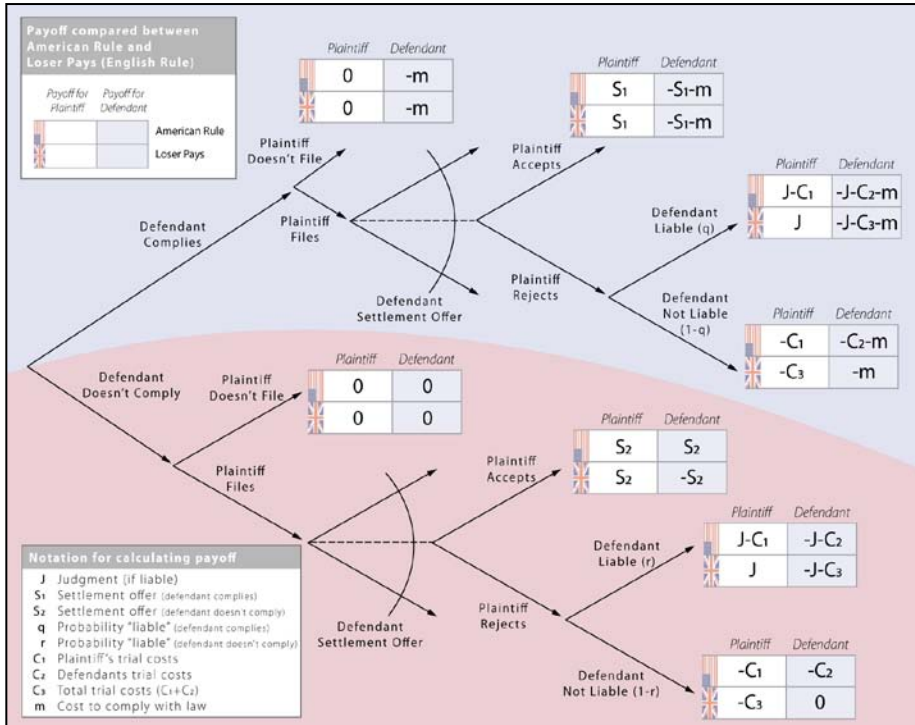
In this simple model, a potential defendant must decide whether to take a specific action at a fixed cost in order to comply with the law, for example, applying a non-skid surface to the front steps of a business. This model assumes that courts sometimes make errors but that they are correct more often than they are wrong (that is, it assumes that: $1 > r > .5 > q > 0$). A potential defendant can minimize its expected costs by spending up to the dollar amount represented by the variable m in order to comply with the legal standard of care. For example, a business will choose to install that aforementioned non-skid surface only if doing so costs less than m.

The mathematically inclined can solve for the optimal values of m under the American rule and under loser pays by setting the defendant's expected costs for compliance and noncompliance at trial equal to each other:

Finding optimal compliance expenditure under the American rule yields:

$$q(-J - C2 - m) + (1 - q)(-C2 - m) = r(-J - C2) +$$
$$(1 - r)(-C2) ==> m(\text{American})^* = J(r - q)]$$

Finding optimal compliance expenditure under a loser pays rule yields:

$$q(-J - C3 - m) + (1 - q)(-m) = r(-J - C3) + (1 -$$
$$r)(0) ==> m(\text{loser pays})^* = J(r - q) + C3(r - q)$$

Because we know that $r > q$, we can now see that the optimal value of m under a loser pays rule is always higher than the optimal value of m under the American rule. This means that a potential defendant will be motivated to spend more money on safety measures such as non-skid surfaces in a loser pays system. An additional benefit not reflected in this simple model is that, if the prospective defendant complies with the law, a potential plaintiff's injury is less likely to take place at all, a humanitarian as well as financial benefit.

Economist Keith N. Hylton estimated the effect that a loser pays rule would have on legal compliance compared to the American rule.[63] His model assumed that potential defendants would analyze compliance decisions on the basis of the probability of injury; parties' likelihood of filing suit, settling, or litigating; and likely trial judgment.[64] The results of Hylton's simulation suggest that a loser pays rule would significantly increase the resources that defendants devote to complying with legal standards, and thus reduce the number of people injured.[65]

Hylton also attempted to determine which system maximized overall social welfare by adding up the costs of injury, compliance, and litigation under alternative regimes. Hylton's model suggested that settlement rates would go down somewhat, but that the costs associated with lower settlement rates were dwarfed by the welfare-enhancing effect of greater

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[63] Hylton, *supra* note 43. For his earlier version of the tort liability model, *see* Hylton, *supra* note 35. This earlier version did not yield as strong a compliance effect because it failed to capture the effects of fee shifting on settlement offers. Hylton, *supra* note 43, at 154 n.7.

[64] Hylton, *supra* note 43, at 155-58.

[65] *Id.* at 162.

legal compliance and increased public safety.[66] Hylton concluded that loser pays was superior to the American rule at conserving resources and avoiding injuries.[67]

PART IV: LOSER PAYS IN ACTION

Americans litigate far more often than do residents of other nations. The share of our economy spent on litigation is at least twice that of Germany, France, England, and Northern Ireland, respectively.[68] Our outsize litigation rates are driven in part by the fact that the American rule encourages nuisance suits, but myriad other differences between nations make it impossible to determine the size of that effect compared to the many other reasons why litigation rates differ between countries.[69] For example, residents of nations with more comprehensive social insurance systems have fewer otherwise uncompensated costs associated with injuries and therefore may be less motivated to file lawsuits.[70] Therefore, arguments for loser pays in the U.S. should not rely too heavily on international differences in litigation rates uncontrolled by other relevant differences in the laws, politics, and populations of the countries compared.

Since controlling for all such differences is impracticable, it is fortunate that there is some domestic evidence about the likely effects of a loser pays rule in the United States. Alaska has always had a loser pays rule, and Florida briefly experimented with a loser pays rule applied only to medical-malpractice suits.

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[66] *See id.*

[67] *Id.* at 168.

[68] TOWERS PERRIN TILLINGHAST, *supra* note 1, at 4.

[69] *See generally* RICHARD A. POSNER, LAW AND LEGAL THEORY IN ENGLAND AND AMERICA 76-79 (1996).

[70] *See* Dana A. Kerr, et al., "A Cross-national Study of Government Social Insurance as an Alternative to Tort Liability," 76 J. OF RISK & INS. 367, 368 (2009).

THE ALASKAN EXPERIENCE

Uniquely among the states, Alaska has had a nearly universal loser pays rule since it became a state in 1900.[71] Rule 82 of the Alaska Rules of Civil Procedure provides: "Except as otherwise provided by law or agreed to by the parties, the prevailing party in a civil case shall be awarded attorney's fees calculated under this rule."[72] The rule calculates fee awards for plaintiffs as a percentage of money damages recovered: 20% of the first $25,000 and 10% of any additional sums recovered at trial.[73] Prevailing defendants are awarded 30 percent of their actual attorneys' fees for tried cases and 20 percent of actual fees for cases terminated by other means.[74]

Evidence of the effect of Alaska's loser pays rule on its rate of civil filings is ambiguous. Alaska recorded 5,793 civil filings per 100,000 inhabitants in 1992.[75] This number was only slightly below the national median of 6,610 per 100,000 that year.[76] The composition of civil filings, though, differs somewhat from the national pattern.[77] Domestic relations and probate matters, which are not governed by loser pays, form a much larger share of total civil litigation in Alaska (where they are 60% and 19% of the total Alaska caseload, respectively) than in the United States generally (where they comprise only 39% and 10% of the total

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[71] Act of June 6, 1900, ch. 786, §§ 509-28, 31 Stat. 321, 415-18.

[72] ALASKA R. CIV. P. 82(a).

[73] *Id.* at 82(b)(1). Lesser percentages are recoverable in cases that are settled or are uncontested. *See id.*

[74] *Id.* at 82(b)(2). Plaintiffs who sue for nonmonetary damages may recover under this provision as well. *See id.*

[75] SUSANNE DI PIETRO ET AL., ALASKA'S ENGLISH RULE: ATTORNEY'S FEE SHIFTING IN CIVIL CASES 79-80 (1995), *available at* http://www.ajc.state.ak.us/reports/atyfee.pdf.

[76] *Id.*

[77] *See id.* at 84.

caseload, respectively).[78]   By the same token, Alaska's tort claims constitute a smaller share of Alaska's litigation mix (5%) than they do in the country as a whole (10%).[79] These statistics suggest, but certainly do not prove, that loser pays may be responsible for more selective filing of tort claims in Alaska than in other jurisdictions.

Most attorneys surveyed by the Alaska Judicial Council thought that Alaska's loser pays rule did not significantly reduce the number of filings of "frivolous" suits because plaintiffs who file most such suits do so for "emotional," rather than financial, reasons.[80] But the Council's survey question, in asking about "frivolous" suits, was misleading, since "frivolous" is a legal term of art denoting only truly outlandish legal claims, as opposed to merely weak ones. In fact, the Council concluded, on the basis of interviews with Alaska attorneys, Alaska's loser pays rule reduced the number of low-merit cases filed by rational, middle-income plaintiffs.[81]   The Council's finding was merely qualitative, not quantitative, but nevertheless important, especially since defendants are able to recover only 20--30% of their actual fees under Alaska's rule.   The Alaska Judicial Council also collected evidence indicating that small meritorious claims, particularly those seeking to collect on an unpaid debt, were filed more frequently in Alaska due to the likely availability of a fee award.[82] This finding is consistent with the theoretical literature.

It is difficult to generalize from Alaska's experience with loser pays on account of Alaska's unique geography. The state has enormous natural resource reserves,[83] a large indigenous

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[78] *Id.* at 83-84.

[79] *Id.*

[80] DI PIETRO ET AL., *supra* note 73, at 132.

[81] *Id.* at 139.

[82] *Id.* at 104-05.

[83] *See* Alaska Dep't of Labor & Workforce Dev., Alaska Gas Inducement Act Training Strategic Plan: A Call to Action 5 (2009) , *available at* http://labor.state.ak.us/AGIA_teams/docs-combined/agiaweb.pdf.

population,[84] and substantially more men than women.[85] Any one of these factors could affect the rate of tort litigation alone or in combination in ways that are not fully understood. For example, there is some evidence that men are more likely than women to be involved in legal disputes.[86] Nonetheless, the available evidence suggests that Alaska has under-implemented a fundamentally sound policy, which better compensates deserving small claimants and discourages the kinds of filings that have a low probability of success. While fee shifting is standard in Alaska, the state's fee schedules fail to compensate prevailing parties fully for their litigation costs, reducing the rule's salutary effects.

THE FLORIDA EXPERIMENT

In 1980, Florida embarked on an important experiment. In response to escalating medical-malpractice insurance rates, the state legislature adopted a loser pays rule exclusively for medical-malpractice lawsuits.[87] The Florida Medical Association and the insurance industry lobbied for the provision, which they hoped would reduce the rate of abusive litigation and thus the insurance premiums paid by doctors and hospitals.[88] However, both groups quickly discovered a problem

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[84] *See Alaska Quick Facts*, U.S. CENSUS BUREAU (Nov. 4, 2010 12:46:17 EDT), http://quickfacts.census.gov/qfd/states/02000.html (American Indian and Alaska Native persons make up 15.2% of the population of Alaska and only 1% of the United States population as a whole.)

[85] *Id.* (Women comprise 48.1% of the population of Alaska and 50.7% of the population of the United States as a whole.)

[86] *See, e.g.*, Michael J. Goldberg, *The Propensity to Sue and the Duty of Fair Representation: A Second Point of View*, 41 INDUS. & LAB. REL. REV. 456, 457 (1988).

[87] Ch. 80-67, 1980 Fla. Laws 225 (codified at FLA. STAT. § 768.56 (1980)), *repealed by* ch. 85-175, 1985 Fla. Laws 1225.

[88] *See* Avram Goldstein, *Lawyer's $4.4-Million Award Ignites Furor*, MIAMI HERALD, Sept. 28, 1982, at A1.

with the new system—the frequent inability of victorious defendants actually to collect their attorneys' fees from insolvent plaintiffs[89]—and they were taken aback by the multi-million dollar plaintiff's attorneys' fee that a Florida doctor who had lost the case against him was ordered to pay.[90] With every interest group lobbying for its repeal, Florida's loser pays law was wiped from the books in 1985.[91]

The first rigorous analysis of the Florida law's effects was published five years later, and its findings suggest that the loser pays experiment was given short shrift by policymakers and its erstwhile advocates.[92] Economists Edward A. Snyder and James W. Hughes found that 54% of medical malpractice plaintiffs voluntarily dropped their lawsuits under Florida's loser pays rule, while only 44% of plaintiffs dropped their suits when the American rule was in force both before and after the loser pays rule was in effect.[93] Loser pays also almost halved the share of medical malpractice lawsuits that went to trial—from 11% to 6% (see Figure 8).[94]

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[89] COMM. ON HEALTH CARE & INS., FLA. H.R., STAFF ANALYSIS OF HB 1352, H.R. DOC. NO. PCB85-02/BS, at 8 (1985).
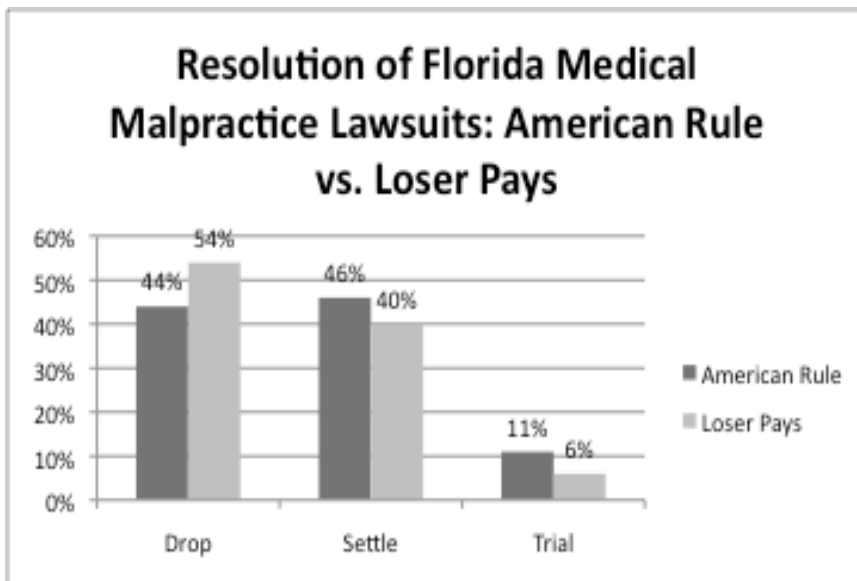
[90] B. Richard Young, Comment, *Medical Malpractice in Florida: Prescription for Change*, 10 FLA. ST. U. L. REV. 593, 608 (1983).

[91] *See* ch. 85-175, 1985 Fla. Laws 1225.

[92] *See* Snyder & Hughes, s*upra* note 35, at 377-78.

[93] *See id.* at 363-64.

[94] *See id.* at 364.

Figure 8[95]

Resolution of Florida Medical Malpractice Lawsuits: American Rule vs. Loser Pays

Note: Percentages may not add up to 100 due to rounding.

Supporting the hypothesis that more plaintiffs with weak suits dropped them under Florida's loser pays rule, cases governed by loser pays were settled for higher amounts ($94,489), on average, than were cases governed by the American rule ($73,786).[96] Most notably, settlements of less than $10,000 dropped from 49% of all settled cases under the American rule to less than 37% under loser pays,[97] suggesting that some low-value settlements under the American rule were paid to the sort of nuisance complainant who did not actually file suit or the sort of plaintiff who dropped his lawsuit during the period when loser pays was in force.

Similarly, while a smaller percentage of medical-malpractice suits went to trial in the years that the loser pays rule was in effect, the average trial award came close to tripling, from

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[95] *See id.* at 363-64.

[96] James W. Hughes & Edward A. Snyder, *Litigation and Settlement Under the English and American Rules: Theory and Evidence*, 38 J.L. & ECON. 225, 243 tbl.7 (1995).

[97] *Id.*

$25,190 to $69,390 in constant dollars, and plaintiffs more often prevailed at trial.[98] Hughes and Snyder concluded that the higher average was the direct result of the loser pays rule's elimination of many weak cases: "Having found that plaintiff prospects improve under the English rule, we are able to establish that these effects necessarily reflect an improved selection of claims reaching the settle-versus-litigate stage."[99]

Florida did experience an increase in per-case litigation expenses, both for those that settled and those that proceeded to trial during the loser pays experiment.[100] However, because the average trial award almost tripled during this period as well,[101] it is possible that defendants were simply spending more on each individual case because the pool of cases was smaller but stronger (i.e., the stakes were higher, and therefore the extra effort put into defending them was well worth making).

While the evidence from Florida's ambitious experiment is ambiguous and complex, it confirms to a striking degree predictions made in the theoretical literature: litigants with weak cases were more likely to abandon their claims under loser pays, which allowed lawyers and courts to focus on more meritorious suits. The increased size of the average settlement and judgment under Florida's temporary loser pays regime also tends to support this view. Litigation expenses per case, including attorneys' fees, did rise during this period,[102] although it remains possible that expenditures for cases of similar size and merit were unchanged.

Did Florida's version of loser pays work better or worse there than the American rule? The large increase in dropped claims and the lower rate of trials suggest that Florida's loser pays law was a promising experiment that lawmakers abandoned too quickly. Doctors referred to anecdotal evidence that the rule

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[98] *See id.* at 240 tbl.5.

[99] *Id.* at 226.

[100] Snyder & Hughes, *supra* note 35, at 375 tbl.6.

[101] *See* Hughes & Snyder, *supra* note 96, at 240 tbl.5.

[102] Snyder & Hughes, *supra* note 35, at 375 tbl.6.

favored losing plaintiffs with few assets, who couldn't afford to pay the winning defendants' attorneys' fees.[103] But, Hughes and Snyder surmise, loser pays actually encouraged plaintiffs with assets to drop weak cases early in order to avoid having to pay a fee award.[104] Be that as it may, at least some percentage of plaintiffs proved judgment-proof, preventing winning defendants from collecting their fees and blunting the incentive effects of the law. In view of Florida's experience, those advocating loser pays rules should take into account the problem of judgment-proof plaintiffs and consider insurance or other devices to ensure that plaintiffs without assets did not stop the rule from functioning.

PART V: PRESERVING ACCESS THROUGH INSURANCE

As we have seen, loser pays rule can be expected to reduce the volume of nuisance litigation and more fully compensate plaintiffs who win cases. These gains would come at an unacceptable price, though, if the new rule discouraged injured people of little means from seeking justice out of fear that they might be liable for a ruinous fee award. Proponents of loser pays reforms must explain how their proposals will preserve functional access to justice for poor and middle-income plaintiffs.

Loser pays countries usually preserve access by making available a combination of public- and union-funded legal aid programs and legal expenses insurance, all of which indemnify participating plaintiffs for attorneys' fees in the event of a

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[103] Florida law formally exempted litigants from liability for their opponent's attorneys' fees if they were unable to pay them. FLA. STAT. § 768.56 (1980) ("[A]ttorney's fees shall not be awarded against a party who is insolvent or poverty-stricken."), *repealed by* ch. 85-175, 1985 Fla. Laws 1225. *See* Snyder & Hughes, *supra* note 35, at 356 (noting that this provision seldom benefited defendants).

[104] *See* Snyder & Hughes, *supra* note 35, at 377-78. Their observation is consistent with the finding in Alaska that its loser pays rule reduces low-merit filings by middle-class, but not poor, litigants. *See* DI PIETRO ET AL., *supra* note 75, at 102.

courtroom loss.[105]   Because union membership in the United States has declined significantly in recent decades,[106] and because public legal aid in the United States is not funded generously enough to provide legal services to all qualified applicants,[107] legal expenses insurance is the most likely of these mechanisms to play the role of ensuring access to U.S. courts if a loser pays rule is widely adopted.

Legal expenses insurance (LEI) takes two common forms in loser pays jurisdictions. The first is traditional LEI, for which a premium is charged every month and which covers any legal expenses of either a future plaintiff or a future defendant that might arise as the result of events, such as an accident, that occur after the policy is in place. These traditional policies pay the legal expenses of suits initiated by the covered party, assuming that the insurance company deems the suit in question to have a solid basis.[108]

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[105] *See* Neil Rickman, Paul Fenn & Alastair Gray, *The Reform of Legal Aid in England and Wales*, 20 FISCAL STUD. 261, 262 (1999).

[106] Gerald Mayer, Union Membership Trends in the United States 10 (2004), *available at* http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1176&context=key_workplace&sei-redir=1#search="Gerald+Mayer+Union+Membership+Trends".

[107] LEGAL SERVICES CORP., DOCUMENTING THE JUSTICE GAP IN AMERICA: THE CURRENT UNMET CIVIL LEGAL NEEDS OF LOW-INCOME AMERICANS 5 (2005), *available at* http://www.lsc.gov/press/documents/LSC%20Justice%20Gap_FINAL_1001.pdf.

[108] Anthony Heyes, Neil Rickman & Dionisia Tzavara, 24 INT'L REV. L. & ECON.,107, 108 (2004) ("In principle, the effects of LEI are manifold and will include the signaling associated with an insurer being willing to allow a policyholder to pursue a case (this will usually be done after a merits test) . . . .").

The second type of LEI is "after-the-event" (ATE) legal expenses insurance, which a party claiming injury can purchase at the time he files a lawsuit and which will relieve him of the obligation to pay the defendant's attorneys' fees out of pocket if his suit is unsuccessful.[109] ATE premiums can be advanced by the plaintiff's lawyer as costs, or they can take the form of a percentage stake in any recovery; either way, an upfront contribution by the plaintiff, particularly one of limited means, is not required. [110] In some jurisdictions, the ATE premiums that a winning plaintiff has paid can be recovered from a losing defendant.[111]

Both types of litigation insurance—traditional LEI and ATE— protect the viability of strong cases while discouraging weak ones by denying coverage or charging higher rates. Insurance coverage spreads the cost of losing a good case across many legitimate claimants, while careful underwriting keeps poor cases from being filed.

Some will object to the notion of making insurance companies, in effect, the courts' gatekeepers. American plaintiffs' lawyers already screen potential cases as to merit and decline to handle at least half of prospective claims that they are offered.[112] In a competitive insurance market, plaintiff's lawyers could shop their cases among insurers. And nothing need prevent a plaintiff's lawyer herself from assuming the risk of paying a defendant's legal fees—that is, accepting self-insurance, in effect, as an additional contingent cost of taking a case.[113] If a

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[109] Kritzer, *supra* note 58.

[110] *See, e.g., After the Event Products and Services*, LEGAL EX, http://www.legalexplus.com/after-the-event-insurance.asp (last visited May 11, 2011) (charging no premium until successful conclusion of case).

[111] *See* John Peysner, *A Revolution by Degrees: From Costs to Financing and the End of the Indemnity Principle*, WEB J. OF CURRENT LEGAL ISSUES (2001), http://webjcli.ncl.ac.uk/2001/issue1/peysner1.html.

[112] *See* KRITZER, *supra* note 5, at 71.

[113] Legal ethics requirements in some jurisdictions might have to be modified to enable a plaintiff's attorney to assume a client's risk of bearing legal expenses.

claim were denied both ATE coverage and self-insurance by a plaintiff's attorney, it would be because it was highly unlikely to succeed,[114] making it the very type of claim that loser pays was designed to discourage.

The experience of foreign countries suggests that a market for legal expenses insurance could develop rather easily in the United States. Traditional LEI is particularly popular in Germany, where about 42% of all households have policies.[115] By law, it is a stand-alone product there, but it can be offered as an add-on to homeowner's insurance or auto insurance in other loser pays countries, as it usually is in England.[116]

The cost of traditional LEI is generally modest.[117] Some traditional LEI policies cover the hourly fees that the plaintiff owes his attorney (unless, of course, the losing defendant pays them), eliminating the need to hire attorneys on a contingent basis. Such policies also insure plaintiffs against the risk of having to pay an adverse fee award, at least up to some stated limit.[118] If American jurisdictions adopted loser pays, traditional LEI policies would have a market among middle-income Americans who have assets to protect and commonly

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[114] Certain classes of cases, while unlikely to succeed, might nevertheless have some social merit. Fortunately, the most obvious of these, federal constitutional claims, are set out by separate statute and would be exempted from a general loser pays rule. Other exceptions could be created as appropriate.

[115] Matthias Kilian, *Alternatives to Public Provision: The Role of Legal Expenses Insurance in Broadening Access to Justice: The German Experience*, 30 J.L. & Soc'y 31, 38 (2003).

[116] *Id.* at 39.

[117] A white paper from the Office of the Lord High Chancellor observes: "The premiums, often between £4 and £20, are so small that most people do not realize they have cover in the event that they need to go to law." Lord High Chancellor, Modernising Justice 22 §2.35 (1998).

[118] *See* Jon Robins, *Can the Insurance Industry Plug the Justice Gap?*, Legal Action, Jan. 2009, at 10, *available at* http://www.lag.org.uk/files/92761/FileName/January_LA_10_11.pdf.

carry other forms of insurance, such as life insurance, homeowner's insurance, and traditional liability insurance.

Recent policy changes in England and Wales have shown that insurers can quickly respond to them by providing needed products. In 1990, Parliament passed a measure legalizing "conditional fee agreements" (CFAs) for personal injury claims and certain other proceedings.[119] Under a CFA, a client need pay his lawyer nothing if his case is lost but must pay a "success fee" (in addition to regular fees recovered from the defendant) if the case is won.[120] In 1998, the government extended the measure to allow CFA agreements in all civil cases except those involving family law.[121]

At the same time, Parliament phased out civil legal aid entirely for personal injury plaintiffs and made other forms of aid available to only a small minority of the population.[122] The former eligibility of a majority may have had the effect of artificially stunting the market for legal expenses insurance.

These twin reforms—liberalizing CFAs and cutting legal aid—effectively privatized personal injury litigation in England and Wales. Lawyers and insurers, rather than taxpayers, are now underwriting litigation risk for plaintiffs, and a variety of ATE policies have been introduced by more than half a dozen insurance companies, which advertise ATE policies online;[123] at

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[119] Adrian Walters & John Peysner, *Event-Triggered Financing of Civil Claims: Lawyers, Insurers and the Common Law*, 8 NOTTINGHAM L.J. 1, 8 (1999).

[120] LORD HIGH CHANCELLOR, *supra* note 117, at 24 §2.42.

[121] *Id.* at 24 §2.43.

[122] *See* Rickman, Fenn & Gray, *supra* note 105, at 275-76.

[123] *See, e.g., After the Event Insurance (ATE Insurance)*, THE JUDGE, http://www.thejudge.co.uk/after-the-event-insurance (last visited Apr. 5, 2011); *After the Event Insurance & Litigation Funding – ATE Insurance*, 1ST CLASS LEGAL, http://www.ateinsurance.com (last visited May 12, 2011); *After the Event Insurance (ATE), Legal Expenses Insurance, Negligence and Litigation*, LAWASSIST, http://www.lawassist.co.uk (last visited Apr. 5, 2011); LEGAL EX, *supra* note 110; *Legal & Protection* Services, HSBC INSURANCE (Aug. 6, 2007), http://web.archive.org/web/20070806021811/http://www.insurancebrokers.hsbc.com/hsbc/legal_protection (accessed by searching for Insurancebrokers.hsbc.com/hsbc/legal_protection in the Internet Archive index); *Legal Expenses*, FIRSTASSIST, http://www.legalexpenses.co.uk/ (last

least two post applications, as well, online.[124] They are four to six pages in length and are filled out by plaintiffs' attorneys. The premium, which may be as low as £85 and is generally "£100 or more," can be advanced by the applicant's lawyer.[125] If the plaintiff prevails, he can also recover from the defendant the premiums he has paid.[126] At least some advertised ATE policies do not charge the premium until the case settles or until a verdict has been rendered in the plaintiff's favor.[127]

In 2003, ATE constituted about 29% of the larger LEI market in Britain and collected some £110 million in premiums.[128] A British trade publication recently estimated that ATE insurance is now purchased for three in four civil lawsuits filed under conditional fee agreements.[129] The rapid growth of the ATE insurance market in England and Wales should help assure observers of the American legal scene that legal expenses insurance can effectively preserve access to justice in loser pays jurisdictions.

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visited April 5, 2011); *Litigation Insurance*, STIRLING LEGAL SERVICES (Feb. 10, 2008), http://web.archive.org/web/20080210054758/http://www.stirlinglegal.com/litigation_insurance.php (accessed by searching for StirlingLegal.com in the Internet Archive index); *No Win No Fee Injury Compensation* Specialists, ACCIDENT LINE, http://www.accidentlinedirect.co.uk/Pages/Home.aspx (last visited April 5, 2011).

[124] *See* 1ST CLASS LEGAL, *supra* note 123; THE JUDGE, *supra* note 123.

[125] *See* Rickman, Fenn & Gray, *supra* note 105, at 277.

[126] Yue Qiao, *Legal-Expenses Insurance and Settlement*, 1 ASIAN J. L. & ECON., no. 1, 2010, at 13, *available at* http://www.bepress.com/cgi/viewcontent.cgi?article=1003&context=ajle.

[127] *See, e.g.*, LEGAL EX, *supra* note 123.

[128] OFFICE OF FAIR TRADING, THE UK LIABILITY INSURANCE MARKET: A FOLLOW-UP TO THE OFT'S 2003 MARKET STUDY 34 §5.8 (2005), *available at* http://www.oft.gov.uk/shared_oft/reports/financial_products/oft802.pdf.

[129] Katy Dowell, *False Economy*, THE LAWYER (Feb. 18, 2008), http://www.thelawyer.com/false-economy/131305.article.

PART VI: IMPLEMENTATION GUIDELINES

The Alaska and Florida experiences—and the light they shed on the theoretical literature on fee shifting—suggest that future loser pays reforms should incorporate the following three features.

First, the size and percentage of the fee shifted must be large enough to affect the behavior of potential litigants. Alaska's loser pays rule allows prevailing defendants to be reimbursed only 20% to 30% of their actual legal expenditures, an amount too low to adequately influence a plaintiff's decision about whether to file suit.

Second, loser pays works best if defendants can recover their fees in cases involving plaintiffs with few personal assets. In many nations with loser pays rules, litigation insurance is available to plaintiffs at a reasonable price. The United States should require plaintiffs to purchase insurance, and it should permit plaintiff's lawyers to advance insurance premiums, as they currently do other litigation costs, in order to preserve access to the courts.

Finally, loser pays reforms should be designed to minimize any possible increases in per-case costs and any possible negative effect settlement rates. In order to accomplish this, loser pays should be accompanied by a modified offer-of-judgment rule (similar to Federal Rule of Civil Procedure 68) that applies to both plaintiffs and defendants. Offer-of-judgment rules impose court costs on plaintiffs who pass up a settlement offer in favor of obtaining a judgment that turns out to be no more generous. If such rules were extended to include attorneys' fees, they would encourage timely settlement of claims.

PART VII: A PROPOSAL FOR REFORM

The following proposal is designed to bring the benefits of loser pays to both the state and federal justice systems. It includes a modified offer-of-judgment device. It is designed to compensate winning litigants more fully and reduce the number of abusive lawsuits, while preserving access to justice for poor and middle-income litigants with strong claims. It should also limit any increases in litigation expenditures and encourage the

parties to make reasonable settlement offers so as to limit their potential liability for attorneys' fees. A formal mathematical model of this proposal is included in an appendix to this article for technical readers.

PROPOSAL

The non-prevailing party in any civil case in which money damages are sought shall indemnify the prevailing party for the costs of litigation and reasonable attorneys' fees. Fees awarded shall be the lesser of 1) actual fees, or 2) 30% of the difference between the final judgment and the non-prevailing party's last written offer of settlement tendered within sixty days of the date that the initial complaint was filed in the trial court.

DETERMINING THE PREVAILING PARTY: The plaintiff is the prevailing party if it obtains an order for a net total judgment amount (including all substantive claims and counterclaims and excluding costs) in excess of the defendant's last written offer of settlement tendered within sixty days of the date that the initial complaint was filed in the trial court. Otherwise, the defendant will be deemed the prevailing party.

ABILITY TO PAY: Within ninety days of the date that the initial complaint is filed in the trial court, the plaintiff shall file proof that assets are available to pay a judgment awarding costs. Such proof may be a litigation insurance policy. The plaintiff's attorney may advance the premium for such a policy, and the plaintiff may recover the premium as costs if the plaintiff is the prevailing party. If the plaintiff does not file such proof, the complaint will be dismissed without prejudice.

VOLUNTARY DISMISSAL: A plaintiff will be liable for costs as a non-prevailing party under this section if it moves to withdraw a lawsuit more than ninety days after the initial complaint was filed.

> MAINTENANCE AND CHAMPERTY: The provision of litigation insurance in accordance with other applicable law shall not be deemed maintenance or champerty.

As previously discussed, greater compliance with the law, more complete compensation for victims, fewer transaction costs, and more equitable distribution of those transaction costs that cannot be avoided are four widely acceptable desiderata of legal procedural reform.[130] This loser pays proposal is designed to promote them all. First, the proposed reform will promote compliance with legal standards of care by making it cheaper for individuals and businesses to take appropriate safety precautions, and by increasing their legal liability when they fail to do so. Because potential defendants will be motivated to invest more resources to ensure public safety, both injuries and litigation should decrease. Businesses and individuals will also, for the same reasons, be more motivated to honor their contractual obligations.

Second, this rule should better compensate plaintiffs with strong cases, whether they succeed at trial or negotiate a settlement armed with the enhanced bargaining power of a likely fee award. Legal expenses insurance will play a critical role by preserving access to justice for plaintiffs of modest means who have decent legal claims. The proposed reform includes a provision protecting insurance providers from liability under traditional common-law doctrines of maintenance and champerty, which have traditionally barred some forms of litigation financing in the United States.[131] Reformers in specific jurisdictions should work directly with insurance regulators to remove any other existing barriers to the rapid development of this important market.

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[130] *See supra*, Part I.

[131] Champerty is: "A bargain between a stranger and a party to a lawsuit by which the stranger pursues the party's claim in consideration of receiving part of any judgment proceeds; it is one type of 'maintenance,' the more general term which refers to maintaining, supporting, or promoting another person's litigation." BLACK'S LAW DICTIONARY 231 (6th ed. 1990).

Third, the proposed reform will lower the overall cost of the civil justice system by reducing the number of low-merit lawsuits filed. Nuisance lawyers would face lower settlement offers in response to weak claims, giving them an incentive to file small, meritorious suits instead or shift to other specialties or professions. The proposed reform's offer-of-judgment feature, limiting fee-awards to an amount equal to 30% of the difference between the relevant settlement offer of the losing party and the amount recovered at trial, is designed to contain per-case costs by promoting early settlement. Parties will want to make their settlement offers as reasonable as possible, because a party's settlement offer limits its liability for attorneys' fees in the event of a loss at trial. The offer-based fee cap will also discourage litigation spending that is out of proportion to the actual stakes of the case.

Finally, this proposal will distribute the costs associated with the civil justice system more equitably. Negligent defendants will pay a greater share of these costs than they now do, as will nuisance lawyers and their clients, and the costs associated with arguable cases will be spread more broadly among all payers of litigation insurance premiums, all defendants, and all taxpayers.

The United States pays a high price for a system of justice that encourages abusive litigation, but it need not continue to do so. Thoughtful reforms in state and federal law can replace the American rule for attorneys' fees with a loser pays system without barring the courthouse door to plaintiffs with modest means but legitimate grievances. England's recent quasi-privatization of civil justice demonstrates that markets for litigation insurance can develop rapidly in response to legal reforms; and reasonable limits to the parties' exposure to liability for fees, if they are incorporated into an offer-of-judgment mechanism, can promote early and efficient settlement.

APPENDIX: A FORMAL MODEL OF A LOSER PAYS REFORM PROPOSAL[132]

Let j (nonnegative) represent the size of the judgment for the plaintiff if the lawsuit proceeds to trial. Let $P(\cdot)$ represent the probability distribution of trial outcomes if the lawsuit does not settle. This means that $P(\hat{j})$ represents the probability that the net total judgment for the plaintiff at trial will be less than $\hat{j}$. Let J represent the expected value of the judgment if the lawsuit goes to trial: $J = \int j \, dP(j)$. Let C_Π and C_Δ represent the plaintiff's and defendant's total attorneys' fees and costs, respectively. Let Φ represent the plaintiff's special settlement offer, and let Ω represent the defendant's special settlement offer. For the sake of simplicity, assume for the moment that: 1) both parties have the same beliefs about $P(\cdot)$; 2) $C_\Pi > .3(J_{\Omega \leq j} - \Omega)$; AND 3) $C_\Delta > .3(\Phi - J_{j < \Omega})$.

The plaintiff's expected gain at trial is:
$$U_\Pi \equiv J - [C_\Pi - .3(J_{\Omega \leq j} - \Omega)] - P(\Omega)[C_\Pi + .3(\Phi - J_{j < \Omega})]$$

The defendant's expected loss at trial is:
$$U_\Delta \equiv J + [C_\Delta - .3(\Phi - J_{j < \Omega})] - [1 - P(\Omega)][C_\Delta + .3(J_{\Omega \leq j} - \Omega)]$$

U_Π is decreasing in Φ, which should encourage the plaintiff to make a modest settlement offer. U_Π is also decreasing in C_Π, meaning that the plaintiff has an incentive to control its litigation costs. Because it is strictly true that $C_\Pi \geq [C_\Pi - .3(J_{\Omega \leq j} - \Omega)]$, this proposal appears to reduce the incentive that the plaintiff has to control its costs. However, in cases in which $[C_\Pi - .3(J_{\Omega \leq j} - \Omega)] \geq 0$ (as will be true in most cases in which expenditures are not already unusually low), the plaintiff's marginal additional expenditures will be internalized, containing total trial expenditures. Notice also that U_Π increases

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[132] This model is adapted from a model suggested by Tai-Yeong Chung, *Settlement of Litigation under Rule 68: An Economic Analysis*, 25 J. LEGAL STUD. 261 (1996). To keep the math as simple as possible, all actors are assumed to be risk-neutral here, but the directional effects are the same if one or both parties are assumed to be risk-averse.

in *J* and decreases in *P(Ω)*, which suggests that the proposal will discourage low-merit lawsuits.

U_Δ is decreasing in Ω, which should encourage the defendant to lower its expected trial costs by making a reasonably generous settlement offer. U_Δ is increasing in C_Δ, and, as in the plaintiff's case, the defendant's marginal expenditure decisions should not be affected by partial indemnity under this loser pays rule (relative to the current American rule) in cases in which $[C_\Delta - .3(\Phi - J_{j<\Omega})] \geq 0$.