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Rule 68, The Modified British Rule, and Civil Litigation Reform

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RULE 68, THE MODIFIED BRITISH RULE, AND CIVIL LITIGATION REFORM

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I. INTRODUCTION

On March 7th, 1995 the United States House of Representatives passed a bill, the Attorney Accountability Act of 1995, which would institute a "loser pays" attorney fee shifting rule for all diversity suits in federal court.[1] Under the rule, a party who rejected a settlement offer and then received a judgment less favorable than the offer would be liable for the attorney's fees and court costs incurred by the opposing party after the date of the rejection. The bill was part of a larger litigation reform effort that included ceilings on punitive damage awards and restrictions on product liability lawsuits. Although the Senate failed to pass a similar bill, litigation reform remains an item of interest to legislators both at the state and federal levels.

The news reports surrounding the House bill include charges by commentators that if enacted the legislation would provide an advantage to corporations, and effectively deny access to the courts to poor and middle-class citizens.[2] The proponents of the legislation, however, described it as a neutral mechanism that would encourage settlement and reduce the incentive to file frivolous legal claims.

My aim in this paper is to examine the incentive effects of the proposed legislation, and the general desirability of nondiscretionary penalties as a method of controlling frivolous litigation.[3] The proposed rule, which I will refer to below as the *Modified British Rule*, bears a close resemblance to Rule 68 of the Federal Rules of Civil Procedure. Rule 68 imposes court costs on the plaintiff who rejects a settlement

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1. *See, e.g.*, John Harwood, *House Votes Bill Requiring Losing Party to Pay Winner's Fees in Certain Suits*, WALL ST. J., Mar. 8, 1995, at A3.

2. *See, e.g., id.*; Ana Puga, *House Votes A Deterrent to Civil Suits;'Loser Pays' Bill Affects US Courts*, BOSTON GLOBE, Mar. 8, 1995, at 1.

3. The previous work in this area, from which this paper has benefited greatly, includes David A. Anderson, *Improving Settlement Devices: Rule 68 and Beyond*, 23 J. LEGAL STUD. 225 (1994); George L. Priest, *Regulating the Content and Volume of Litigation: An Economic Analysis*, 1 S. CT. ECON. REV. 163 (1982); Geoffrey P. Miller, *An Economic Analysis of Rule 68*, 15 J. LEGAL STUD. 93 (1986); Tai-Yeong Chung, Settlement of Litigation under Rule 68: An Economic Analysis, mimeo, Economics Department, University of Western Ontario, March 8, 1995; Dale A. Oesterle, *Proposed Rule 68 on Offers of Settlement*, 10 CORNELL L. F. 11, (1984); Thomas D. Rowe, Jr., *Predicting the Effects of Attorney Fee Shifting*, 47 LAW & CONTEMP. PROBS. 139 (1984).

offer and then receives a less favorable judgment. While Rule 68 is a nondiscretionary one-way penalty, the Modified British Rule is a nondiscretionary two-way penalty.

In considering the incentive effects of the Modified British Rule, I begin the analysis below by considering an expanded version of Rule 68, in which attorney's fees are included in the definition of court costs. Although this may seem a round-about way of trying to understand the effects of the Modified British Rule, I find it a necessary first step. Once the incentive effects of this "expanded Rule 68" are understood, it is straightforward to explain those of the Modified British Rule.

My aim in this paper is not so much to provide a detailed understanding of the incentive effects of the Modified British Rule — though I do hope that is accomplished — but to set out a general framework for understanding the effectiveness of various fee-shifting and penalization schemes as mechanisms for regulating the content and volume of litigation. My conclusions with respect to the Modified British Rule, and variations on it, are largely pessimistic. Such schemes are unlikely to encourage settlement, and will do little to discourage frivolous claimants. If frivolous litigation is a serious problem, it has more to do with the quality of decision-making in the judiciary than with the incentives provided by existing procedural rules. Our legislatures could make considerably more progress, at the state level, in discouraging frivolous litigation by raising the minimum qualifications of judicial candidates.

Section II of this paper presents an economic analysis of Rule 68, with attorneys' fees included in the definition of costs, and the Modified British Rule. I extend previous analyses of Rule 68 by providing a simple mathematical formula for the "expanded Rule 68 penalty" and showing that the incentive effects depend entirely on the parties' perceptions of the penalty. I also analyze incentives to file suit and to comply with the law, two issues that have not been examined in earlier work. Section III further extends this analysis by examining strategic implications. In this section I introduce the concept of a "target zone," in which a settlement offer must fall in order to impose the threat of a penalty on the opposing party. In Section IV I consider alternatives to the Modified British Rule, and in Section V I discuss broader implications of civil litigation reform.

II. Incentives and Litigation Reform: A Comparison of the American Rule, Rule 68 with Attorneys' Fees Included in Costs, and the Modified British Rule

The procedural rules I will be discussing in this paper are the American Rule, Rule 68, and the Modified British Rule recently passed by

the United States House of Representatives. The American Rule, the default rule in American courts, requires each party to pay his own attorneys' fees, win or lose. Court costs, however, are usually imposed on the losing party under the American Rule.[4] Rule 68 requires the court to impose court costs on the plaintiff if he refuses a settlement offer and then receives a judgment that is less than the settlement offer.[5]

The Modified British Rule requires the court to impose court costs and attorney's fees on a party who rejects a settlement offer and then receives a judgment less favorable than the offer.[6] In addition to this, the

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4. *See, e.g.*, Miller, *supra* note 3, at 97. Federal Rule 54(d) provides that "[e]xcept when express provision therefor is made either in a statute of the United States or in these rules, costs shall be allowed as of course to the prevailing party unless the court otherwise directs." FED. R. CIV. P. 54(d).

Court costs are defined in 28 U.S.C. § 1920, which provides in pertinent part:

> A judge or clerk of any court of the United States may tax as costs the following: (1) Fees of the clerk and marshal; (2) Fees of the court reporter for all or any part of the stenographic transcript necessarily obtained for use in the case; (3) Fees and disbursements for printing and witnesses; (4) Fees for exemplification and copies of papers necessarily obtained for use in the case; (5) Docket fees under section 1923 of this title; (6) Compensation of court appointed experts, compensation of interpreters, and salaries, fees, expenses, and costs of special interpretations services under section 1828 of this title.

28 U.S.C. § 1920 (1988).

5. Rule 68 provides as follows:

> At any time more than 10 days before the trial begins, a party defending against a claim may serve upon the adverse party an offer to allow judgment to be taken against him for the money or property or to the effect specified in his offer, with costs then accrued. If within 10 days after the service of the offer the adverse party serves written notice that the offer is accepted, either party may then file the offer and notice of acceptance together with proof of service thereof and thereupon the clerk shall enter judgment. An offer not accepted shall be deemed withdrawn and evidence thereof is not admissible except in a proceeding to determine costs. If the judgment finally obtained by the offeree is not more favorable than the offer, the offeree must pay the costs incurred after the making of the offer.

FED. R. CIV. P. 68.

6. The bill passed by the House provides as follows:

> Section 1332 of title 28, United States Code, is amended by adding at the end the following:
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> (e)(1) In any action over which the court has jurisdiction under this section, any party may, at any time not less than 10 days before trial, serve upon any adverse party a written offer to settle a claim or claims for money or property or to the effect specified in the offer, including a motion to dismiss all claims, and to enter into a stipulation dismissing the claim or claims or allowing judgment to be entered according to the terms of the offer. . . .
>
> (5) If all offers made by a party under paragraph (1) with respect to a claim or claims, including any motion to dismiss all claims, are not accepted and the judgment, verdict, or order finally issued . . . . in the action under this section is not more favorable to the offeree with respect to the claim or claims than the last such offer, the offeror may file with the court, within 10 days after the final judgment, verdict, or order is issued, a petition for payment of costs and expenses, including attorneys' fees, incurred with respect to the claim or claims from the date

Attorney Accountability Act limits the attorney's fees that can be taxed against a party to no more than what that party has paid to his own attorney.[7] The bill also permits the court, at its discretion, to exempt novel legal claims from the penalty.[8] However, to simplify the analysis below, I will ignore the ceiling and the discretionary exemption. Where these provisions have important implications, I will note them. In other words, I will treat the Modified British Rule as an extension of Rule 68, in which attorneys' fees are included in the definition of "costs" and penalties are assessed against both plaintiffs and defendants, rather than plaintiffs alone.

This approach — i.e., treating the Modified British Rule as an extension of Rule 68 — captures the important features of the new rule and at the same time permits me to take advantage of the existing careful analyses of Rule 68. Although seldom used by attorneys,[9] Rule 68 has been a popular subject of research for economists interested in analyzing litigation incentives. However, the analyses are in some respects incomplete. My aim in this section is to fill in the gaps in the literature and to state a general approach toward analyzing the effects of litigation reform.

A. The General Approach: Rule 68 and Incentives

Let me start with a statement of the general approach. Many of the articles on Rule 68 have restricted their analyses to the influence of the rule on incentives to settle lawsuits. That may seem entirely appropriate; virtually all of the commentators have suggested that the purpose of the rule is to encourage settlement. It is therefore quite natural to try to

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the last such offer was made or, if the offeree made an offer under this subsection, from the date the last such offer by the offeree was made.

(6) If the court finds . . . that the judgment, verdict, or order finally obtained is not more favorable to the offeree with respect to the claim or claims than the last offer, the court shall order the offeree to pay the offeror's costs and expenses, including attorneys' fees, incurred with respect to the claim or claims from the date the last offer was made or, if the offeree made an offer under this subsection, from the date the last such offer by the offeree was made, unless the court finds that requiring the payment of such costs and expenses would be manifestly unjust.

H.R. Rep. No. 62, 104th Cong., 1st Sess., 1,2 (1995).

7. Proposed § 1332 of title 28, §§ (e)(6) and (e)(7)(A) provide: ". . . the attorney's fees under paragraph (6) may not exceed . . . the actual cost incurred by the offeree for an attorney's fee payable to an attorney for services in connection with the claim or claims. . . ." *Id.* at 2.

8. Proposed 28 U.S.C. § 1332 (e)(4) provides: "At any time before judgment is entered, the court, upon its own motion or upon the motion of any party, may exempt from this subsection any claim that the court finds presents a question of law or fact that is novel and important and that substantially affects nonparties." *Id.* at 2.

9. *See, e.g.*, Anderson, *supra* note 3, at 229.

determine whether it accomplishes its purpose. However, the shortcoming of this approach is that it ignores the larger picture. Rule 68, and similar devices, influence not only on the incentive to settle, but also the incentive to file suit, and, marching further back along the decision tree, the incentive to comply with the law.

I will consider all of these influences here. However, because Rule 68 only shifts court costs, I will consider an extension which includes attorneys' fees within the definition of costs. I will call this extension *Expanded Rule 68*. The incentive effects of Expanded Rule 68 are equivalent to those of Rule 68, though amplified by the inclusion of attorneys' fees in the penalty.

Although the labels chosen for the effects and the number of different effects analyzed is somewhat arbitrary, it is helpful to start by distinguishing three categories: *compliance*, *filing*, and *settlement* effects. By compliance effect, I refer to the influence of a fee shifting rule on the incentives of potential injurers to comply with the law, or to take care to avoid causing injury. By filing effect, I refer to the influence of a fee shifting rule on the plaintiff's incentive to file a claim. This includes as a special case an analysis of the plaintiff's incentive to drop a claim that he has filed. The term settlement effect refers to the influence of a fee shifting rule on incentives to settle. The previous literature on Rule 68 focuses almost entirely on the incentives to settle a lawsuit.

A complete analysis of the influence of fee shifting on litigation incentives requires consideration of each of the three effects identified here. The reason is that an analysis that focuses solely on the incentive to settle may be insufficient to generate a useful picture of the overall influence of fee shifting. For example, suppose one concluded that a certain fee shifting proposal, call it Rule X, increased incentives to settle lawsuits. Would it then follow that if we aimed to reduce the amount of litigation, we should adopt the Rule X? No, because it is possible that the Rule X, by reducing incentives to comply with the law, could lead to a dramatic increase in the number of injuries giving rise to legal disputes. Although the percentage of disputes proceeding to a final judgement might be smaller under Rule X than under the status quo, the increase in the base of disputes might completely offset the supposed benefits of Rule X.

To make matters even more complicated, a "general equilibrium" analysis of the incentive effects of fee shifting would have to also take into account the feedback between compliance and filing incentives. Again, suppose Rule X reduces incentives to comply with the law, leading to more injuries. The increase in injuries will lead to an increase in the plaintiff's probability of victory at trial, other things being equal.

That increase, in turn, will encourage more plaintiffs to file suit, encouraging compliance. Thus, the negative effects of Rule X on compliance are reduced by its influence on the incentive to bring suit.

With these problems in mind, I will consider below the effects of the Expanded Rule 68, and draw out the implications for the Modified British Rule. I will not attempt to state a general equilibrium result, which takes into account the interactions between compliance, filing, and settlement effects. That would require a complicated economic model, and specific assumptions on the model that would limit its usefulness a heuristic device.[10] It is enough here to point out the directions of the effects.

B. Filing Effect

Recall that the status quo is the American Rule, under which each party bears its own attorney's fees (and court costs are shifted to the losing party). Is suit more likely to be brought under the American Rule than under Expanded Rule 68?

Assuming the probability of a plaintiff victory is unaffected by the fee shifting rule,[11] suit will be more likely under the American Rule if the plaintiff's expected costs of litigation are smaller under the American than under Expanded Rule 68.

They are smaller. Why? Expanded Rule 68 alters the American Rule in only one respect. It taxes the plaintiff with the sum of court costs and the defendant's attorneys fees, and does this only when the plaintiff wins a judgment less than the settlement offer. Note that when the plaintiff wins, he ordinarily would have to pay only his own attorney's fees under the American Rule. Expanded Rule 68 increases the plaintiff's expected costs by a penalty. Mathematically, the penalty, calculated after a settlement offer has been made and rejected, can be expressed as follows

$$\textit{Expanded Rule 68 Penalty} = P_p(1\text{-}V_p)(F_d + C_p + C_d)\ ,$$

where P_p = plaintiff's estimate of the probability of judgment for the plaintiff; V_p = plaintiff's estimate of the probability that the judgment is greater than or equal to the settlement offer, given plaintiff victory; F_d = defendant's attorney's fees; C_p = plaintiff's court costs; C_d = defendant's court costs. The first two terms of the penalty reflect the fact that the penalty is assessed only when (1) the plaintiff wins, and (2) his judge-

10. For such a model, see Keith N. Hylton, *Litigation Cost Allocation Rules and Compliance with the Negligence Standard*, 22 J. LEGAL STUD. 433 (1993).

11. This is invalid generally given the feedback effects discussed above. *See id.*

ment, given victory, is less than the settlement offer.

Thus, the incentive to file suit is lower under Expanded Rule 68 than under the American Rule. It is lower because a plaintiff's expected litigation costs are higher under the Expanded Rule 68, the difference reflecting the penalty.

The penalty is the key determinant of the incentive effects of Expanded Rule 68 and the Modified British Rule. Before discussing the remaining effects, however, note that if V_p is equal to one, the penalty is equal to zero. In words, this means that if in the plaintiff's view the probability that the judgment is less than the settlement offer is zero, the perceived penalty is also zero. The plaintiff will hold this view when the amount of the damage is not in dispute.[12] In that case, an offer above the stipulated amount would be accepted by the plaintiff, while an offer below the stipulated amount could (and would) be rejected by the plaintiff without fear of the imposition of a penalty. *Thus, for either Rule 68, Expanded Rule 68, or the Modified British Rule to have any affect at all, there must be some uncertainty regarding the size of the judgment.*

C. Settlement Effect

Because Expanded Rule 68 is merely an amplified version of Rule 68, the settlement incentives created by it are the same as those created by Rule 68. I will therefore take advantage of the careful analyses of Rule 68 settlement incentives in the articles by Miller and Chung.[13]

As Chung notes, the settlement incentives created by Rule 68 are difficult to state with precision.[14] The reason is that Rule 68 penalty is imposed only after a settlement offer has been made and rejected. But the defendant decides whether to make the offer at an earlier stage. Consider the diagram below (Figure 1). It indicates the path of events leading to the imposition of a penalty on the plaintiff, under either Rule 68, Expanded Rule 68, or the Modified British Rule. In the first stage, the defendant decides whether to make a settlement offer. In the second, the plaintiff decides whether to accept or reject the offer. The settlement incentives created by the penalty are dependent upon the stage at which those incentives are examined. Previous analyses have tended to focus on the second stage, after an offer has been rejected. But the overall probability of a settlement is determined by incentives at each stage.

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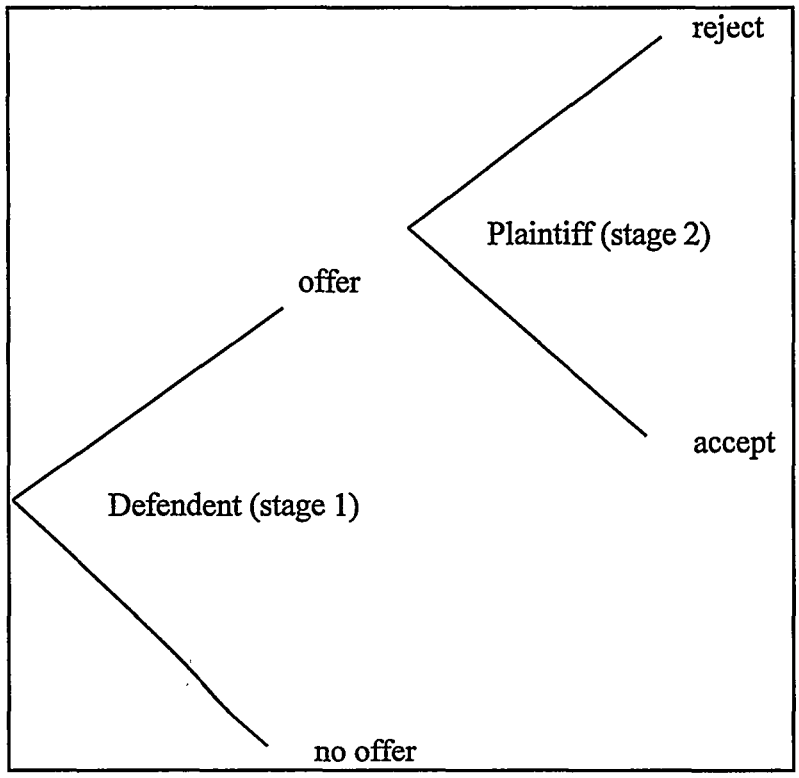
12. This was first noted in Miller, *supra* note 3, at 104.
13. Miller, *supra* note 3; Chung, *supra* note 3.
14. Chung, *supra* note 3, at 9.

FIGURE 1


reject
Plaintiff (stage 2)
offer
accept
Defendent (stage 1)
no offer

A complete analysis of the settlement effect under Rule 68 (or Expanded Rule 68 or the Modified British Rule) would require an examination of the effects of the rule on litigation strategies over several periods. Figure 1 could be extended by adding later stages at which the parties decide whether to make and whether to accept settlement offers. If the sum of the probabilities along all the paths leading to settlement were greater under Rule 68 than without the rule, we could say that Rule 68 leads to enhancement of the incentive to settle. But no study, so far as I am aware, has taken this approach.[15]

I will follow the conventional approach below by focusing on settlement incentives after rejection of the initial offer, i.e., after stage 2 in Figure 1. Although this approach is incomplete in some respects, it has the advantage of simplicity, and probably captures most of the important influences on settlement. In a later section I will extend this analysis by incorporating strategic considerations.

Working within these constraints, the settlement effect of Expanded Rule 68 is easy to explain because it follows, more or less, from the previous discussion of the penalty. Expanded Rule 68 modifies the American rule by the introduction of a penalty, transferred from the plaintiff to the defendant.

How does this affect the incentive to settle? The standard approach to this question assumes that the probability of settlement increases with the size of the settlement zone, the range between the plaintiff's minimum settlement demand and the defendant's maximum settlement offer.[16] Recent analyses of litigation have introduced other concerns, such as credibility, and informational asymmetry.[17] However, this recent work has not led to results that are inconsistent or irreconcilable with

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15. Chung comes closest by pointing out the difficulty described here. Chung shows that the range of attractive offers to the defendant is larger in the first stage than after the second stage. *See id.* This result suggests that the conventional approach, which focuses on incentives after the second stage, may not provide an accurate description of the overall settlement incentives.

16. *See* William M. Landes, *An Economic Analysis of the Courts*, 14 J. L. & ECON. 61 (1971); John P. Gould, *The Economics of Legal Conflicts*, 2 J. LEGAL STUD. 279 (1973); Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399 (1973). The claim that the probability of a settlement increases with the size of the settlement zone is stated most clearly in Posner, *supra* at 418. However, this claim is questionable. It is possible that the probability of a settlement may decline as the settlement zone increases, because parties are more likely to hold out for their best settlement terms. I will assume in this paper that the settlement probability increases with the size of the settlement zone.

17. *See, e.g.*, Lucian Arye Bebchuk, *Litigation and Settlement under Imperfect Information*, 15 RAND J. ECON. 404 (1984); Barry Nalebuff, *Credible Pretrial Negotiation*, 18 RAND J. ECON. 198 (1987); I. P. L. Png, *Litigation, Liability and Incentives for Care*, 34 J. PUBLIC ECON. 61 (1987); Kathryn E. Spier, *The Dynamics of Pretrial Negotiation*, 59 REV. ECON. STUD. 93 (1992); Hylton, *supra* note 10.

earlier articles focusing exclusively on the settlement zone.

Before stating the result, let us consider an example that conveys the intuition behind it. Suppose you are trying to sell your house. You have a minimum asking price of $100,000, which is the lowest at which you are willing to sell. The prospective buyer has a maximum offer price of $130,000, which is the most he is willing to pay. The ultimate transaction price will lie somewhere between the minimum asking and maximum offer prices; thus, the settlement zone is the interval bounded below by $100,000 and above by $130,000. Suppose the city council passes an ordinance requiring the buyer to pay you $10,000 once a deal to transfer the house has been reached. How does this affect the likelihood of a deal being reached? Assuming the buyers and sellers are rational, there should be no effect. Why? Knowing that he will have to pay you $10,000, the buyer will lower his maximum offer price to $120,000. Knowing that you will receive $10,000, you will lower your minimum asking price to $90,000. The new settlement zone will be the interval bounded below by $90,000 and above by $120,000. Note that the size of the settlement zone has not changed. Thus, the likelihood of a deal being reached between you and the prospective buyer is unaffected by the city's ordinance.

This argument carries over to the settlement of litigation, though the story is a bit more complicated. The plaintiff's minimum settlement demand is determined by what he can get out of litigating all the way to a judgment. The Expanded Rule 68 penalty, however, reduces the amount of the expected judgment to the plaintiff. The plaintiff will therefore reduce his minimum settlement demand by an amount equal to the penalty. The defendant, taking the penalty into account in determining his maximum settlement offer, also will reduce his maximum settlement offer. If the size of the penalty were unrelated to the defendant's settlement offer, and both the plaintiff and the defendant have similar predictions of the trial outcome, the amount the defendant would reduce his settlement offer would be equal to the amount by which the plaintiff reduces his settlement demand, so the settlement zone would be unaffected — the equivalent if the house sale example discussed above. However, because the penalty is a positive function of the settlement offer, the defendant reduces his maximum offer by a slightly larger amount than the plaintiff reduces his minimum demand.[18] The end result is that the settlement zone shrinks, but probably not substantially. Thus, *the size of the settlement zone is unaffected by Expanded Rule 68*, which

18. For a careful presentation, *see* Miller, *supra* note 3, at 105–06.

is the central result of Miller's analysis.[19]

Is that all there is to the settlement effect? The answer is no, because I have assumed so far that the parties have the same assumptions regarding the relevant probabilities and costs. *However, if expectations of plaintiffs and defendants differ, Expanded Rule 68 may cause the settlement zone to increase or decrease.*

Where the parties' expectations differ, it is necessary to consider separately the defendant's perception of the penalty. If both parties have the same expectations regarding fees and costs, and their expectations differ only with respect to the probabilities, the defendant's estimate of the Expanded Rule 68 penalty will be

$$P_d(1\text{-}V_d)(F_d + C_p + C_d) ,$$

where P_d = defendant's estimate of the probability of judgment for the plaintiff and V_d = defendant's estimate of the probability that the judgment is greater than or equal to the settlement offer, given plaintiff victory.

Differences in the parties' expectations regarding the penalty will affect the size of the settlement zone. In particular, if the plaintiff's estimate of the expected penalty is larger than the defendant's estimate, then adoption of Expanded Rule 68 will lead to an increase in the settlement zone, and thus a greater likelihood of settlement. The reason is that the plaintiff will reduce his minimum demand by a greater amount than the defendant reduces his maximum offer. Conversely, if the defendant's estimate of the penalty is greater than the plaintiff's, the settlement zone will decrease, reducing the likelihood of a settlement.

D. Compliance Effect

The Expanded Rule 68 penalty reduces the plaintiff's incentive to bring suit, and thus the defendant's incentive to comply with the law. This, in turn, implies an increase in the number of injuries giving rise to disputes. Thus, even if Expanded Rule 68 led to an increase in the likelihood of settlement, its adoption might still be followed by an increase in the total quantity of litigation.

The compliance effect may be weaker under certain conditions. Suppose, for example, plaintiffs file suit before knowing whether the defendant is guilty. In this case, the reduction in compliance, that results from adoption of Expanded Rule 68, will lead to an increase in the plaintiff's expected return from bringing suit (because, on average, more

19. *Id.*

defendants are guilty). So while the penalty reduces the incentive to sue, the reduction in compliance increases the incentive to sue. The net effect, however, probably will be a reduction in the incentive to sue, a reduction in compliance rates, and a corresponding increase in the number of disputes giving rise to litigation.[20]

E. The Modified British Rule

Here I consider the effects of the Modified British Rule, which extends Expanded Rule 68 by incorporating a penalty against the defendant.

1. Filing Effect

Under the Modified British Rule, the plaintiff would no longer face only the risk of being penalized. He would also have the potential gain of receiving a payment from the defendant. The plaintiff's incentive to file suit would therefore be determined by the difference between the expected penalty he may have to pay and the expected penalty he may receive from the defendant, i.e., the plaintiff's "net penalty." Let V'_p = plaintiff's estimate of the probability that the judgment is less than his settlement demand (i.e., the probability that a penalty will not be imposed on the defendant). Let *PNP* = the plaintiff's net penalty under the Modified British Rule. Then

$$PNP = P_p(1-V_p)(F_d+C_p+C_d) + (1- P_p)F_d - P_p(1-V'_p)F_p$$

where the first term, which is the same as the Expanded Rule 68 penalty, reflects the penalty assessed against the plaintiff if he receives a judgment less favorable than the defendant's settlement offer. The second term is the expected penalty imposed on the plaintiff in the event that the defendant makes a settlement offer and the plaintiff loses at trial.[21] The third term reflects the expected reward to the plaintiff if he makes a settlement demand which is rejected by the defendant, and he receives a more favorable judgment at trial. Although the sign of *PNP* is ambiguous generally, it should be clear that *for optimistic plaintiffs (those who believe the probability of success at trial is high), the expect-*

20. *See* Hylton, *supra* note 10, at 467, 468 (demonstrating that incentives to comply fall as litigation costs increase). The demonstration that compliance falls as litigation costs increase suggests that adoption of the MB rule will reduce compliance because the rule is equivalent to an increase in the cost of bringing a lawsuit.

21. Note that this is important difference between the Modified British Rule and Rule 68. Rule 68 shifts court costs only if the plaintiff gets a positive judgment from the court, see *Delta Air Lines, Inc. v. August*, 450 U.S. 346 (1981).

ed penalty is smaller under the Modified British Rule than under Expanded Rule 68, and the converse holds as well. Thus, in comparison to Expanded Rule 68, the Modified British Rule encourages optimistic plaintiffs to file suit and discourages pessimistic plaintiffs. Moreover, in comparison to the American Rule, the Modified British Rule encourages optimistic plaintiffs and discourages pessimistic plaintiffs.

In the symmetrical case in which plaintiffs think the court is equally likely to impose a penalty on either party ($V'_p = V_p$) and that the litigation expenses of plaintiffs and defendants are equal ($F_p = F_d$), the plaintiff's net penalty is equal to

$$P_p(1-V_p)(C_p+C_d) + (1- P_p)F_d ,$$

which is positive. *Thus, in the case of perfect symmetry, the plaintiff's incentive to file suit is lower under the Modified British Rule than under the American Rule.*

2. Settlement Effect

If only the defendant makes an offer, then the settlement effect is equivalent to that of Expanded Rule 68. If only the plaintiff makes a settlement offer — demand, to be more precise — then the defendant's incentives are controlled by the defendant's estimate of the expected penalty. From this point, the analysis follows the discussion of previous section. If the plaintiff's estimate is the equal to the defendant's the settlement zone is unaffected; the settlement zone is affected only if the parties estimates of the relevant probabilities and costs differ.

Now suppose both parties make settlement offers. In this situation, both parties must take into account their respective net penalties. *It follows from the foregoing that the ultimate impact of the Modified British Rule on the settlement zone depends on both plaintiff and defendant perceptions of their respective net penalties (PNP and DNP). Those perceptions must differ if the Modified British Rule is to have any influence on settlement incentives.*

It would be a tedious exercise from this point to trace out the cases in which the settlement zone increases and those in which does not, because of differences in the parties' perceptions. However, the results are similar to those under Expanded Rule 68.

3. Compliance Effect

The compliance effect of the Modified British Rule is a function of both *PNP* and *DNP*. Recall that in the case of perfect symmetry of expectations, the plaintiff's net penalty is positive under the Modified

British Rule. It is fairly straightforward to show that the defendant's net penalty is negative, again under the assumption of symmetry in expectations. *This implies that when the parties' expectations are symmetric, plaintiffs generally are less likely to sue under the Modified British Rule than under the American Rule, and defendants are less likely to comply with the law.*

Suppose, however, that parties had the same expectations regarding the probabilities of plaintiff success and of penalization, and also expected the defendant to spend more on litigation. Then the plaintiff's net penalty would be positive (even more so than in the perfect symmetry case) and the defendant's net penalty would be negative. The new rule would discourage victims from filing suit and at the same time, provide a subsidy to potential defendants, since they expected to be rewarded by the penalization rule.

Suppose the parties have the same expectations regarding probabilities, and they expect the plaintiff to spend more on litigation. In this case it is possible for the plaintiff's net penalty to be negative and the defendant's net penalty to be positive. Under these conditions, the new rule encourages lawsuits and at the same time taxes potential defendants. Although this rule would enhance incentives to comply, it would increase litigation and probably encourage suits that might be labeled frivolous.

III. Implications for Litigation Strategy

In light of the foregoing, can we make concrete predictions about how the world would change as the result of adoption of the Modified British Rule? I think so, and it is important to consider some of the observable changes that would follow adoption of such a rule; for the observable effects might easily lead to new efforts to regulate the litigation process. Here I consider implications for litigation strategy.

A switch to the Modified British Rule would affect litigation tactics. To simplify the discussion, let us start by considering the defendant's strategic incentives, and then consider the plaintiff's.

A. Defendant's Strategic Incentives

Because of the possibility of a penalty being imposed on the plaintiff, it will be in the defendant's interest to make a settlement offer. The reason is that the likelihood of a penalty puts pressure on the plaintiff to

reduce his settlement demands.[22] However, the threat of a penalty against the plaintiff arises only if the defendant's settlement offer is one that the plaintiff will reject. Moreover, if the settlement offer is too low, it may fall below the minimum the plaintiff anticipates receiving as a judgment, and in this case, the expected penalty will be zero in the plaintiff's eyes. In short, the Modified British Rule sets up incentives for the defendant to make an offer the plaintiff should want to refuse, but not too low.

More precisely, in order to generate the risk of a penalty on the plaintiff, the defendant's settlement offer has to be in a certain *plaintiff target zone*, which can be defined as the difference between the minimum judgment the plaintiff expects to receive and the net gain the plaintiff expects from the lawsuit, where the plaintiff's net gain is measured in stage 1 of Figure 1. Let J = the plaintiff's expected award and J_m = the plaintiff's expected minimum award, where $J_m < J$. This assumes uncertainty in the distribution of awards, because in the case of absolute certainty $J_m = J$.[23] Settlements within the plaintiff target zone are those greater than J_m and less than $P_pJ - F_p - (1-P_p)(C_p+C_d)$. There is nothing, of course, to guarantee that the plaintiff target zone is not empty.

Even if the plaintiff target zone is not empty, hitting it may be virtually impossible in a large number of instances — which may explain why Rule 68 seems to be ignored by many attorneys, and may suggest that the Modified British Rule, if ever enacted, would not be used widely also. Generating a serious risk of a penalty against a plaintiff is not unlike the task of jumping from a one-story platform into a bathtub full of water. If the surface around the bathtub is soft, there may be little to lose in taking the dive. But if the bathtub is resting on a hard surface, the expected benefits from the dive probably will not be worth the expected costs. The same may be said of Rule 68 and the Modified British Rule in practice. Making an offer in the plaintiff target zone may set up ideal incentives from the defendant's perspective. But if the defendant misses the zone, he may damage his chances to reach a desirable settlement.

It should be clear that the size of the plaintiff target zone will

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22. It was demonstrated in the previous section that if parties have the same perceptions of the relevant probabilities and costs, the penalty does not alter the size of the settlement zone. However, the defendant has a strong incentive to make an offer because the likelihood of penalty, which is created only by the rejection of an offer, reduces the threat point of the plaintiff.

23. I.e., the distribution of possible awards is a single probability mass at J. In the ordinary "bell-curve" shaped probability density case, $J_m < J$.

depend on the characteristics of the claim and the injury suffered by the plaintiff. Assume all claims can be decomposed into *certain* and *uncertain* components. The certain component would consist of easily provable losses suffered by the plaintiff; and the proof would include such things as medical bills, or repair bills from an auto body shop. The uncertain component would consist of claims for certain difficult-to-prove losses, claims for pain and suffering damages, or claims for punitive damages. Obviously, some plaintiff claims will consist largely of certain items, while others will consist largely of uncertain items.

The plaintiff target zone will vary as the uncertain portion of the damage claim increases. Thus, with respect to relatively uncertain claims, we can confidently predict that defendants will have greater incentives to make settlements offers under the Modified British Rule. The reason is that the threat of a penalty will be greater in these instances. On the other hand, when the plaintiff's damage is relatively certain, the target zone will either be extremely narrow or empty. In these instances, the Modified British Rule will have no effect on the parties' incentives.

The incentive to make settlement offers within the target zone will also influence the behavior of plaintiffs, after a settlement offer has been made. Those plaintiffs whose damage claims are in large part uncertain, or relatively unprovable, will have most to fear from settlement offers that fall within the target zone. Thus, a plaintiff who expected to receive $10,000 in certain damages, and possibly as much as $100,000 in punitive damages would be put in a bind by a settlement offer of $30,000. The punitive portion would be highly uncertain, and the plaintiff would face the substantial risk of paying the defendant's attorneys fees if the court refused to award punitive damages.

One might see this as a desirable change in incentives. The introduction of the penalty puts a special burden on plaintiffs who hold out for a largely uncertain surplus that might be added to the provable portion of the damage award. Put another way, the penalty strikes hardest against those plaintiffs who gamble with the system.

But there is another side: there are some plaintiffs whose claims are largely unprovable, but not without merit, and certainly not falling within the realm of gambling behavior. Consider, for example, an attorney who gets an offer from Smith & Smith law firm to join as a partner. Her current employer refuses to match the offer from Smith & Smith, and the ground for this refusal is discriminatory, in violation of Title VII. She would like to sue for damages, but how much is provable? There are no medical or repair bills in this case. However, the economic loss to the attorney may have been substantial. Suppose a

matching offer from her current employer would have pushed Smith & Smith to increase their offer by fifty percent?

If the attorney in this example joins Smith & Smith and files suit against her former employer, she would face the problem that almost all of her alleged loss is unprovable. Smith & Smith might have doubled their offer after seeing a competing bid from her former employer. On the other hand, they might not have budged. Each side would seek experts who would take opposing positions on the likely outcome of a bidding war. But the problem for the attorney in this example is that an early, low-ball settlement offer from her former employer would present a serious risk of a penalty at the end of the game. Is our attorney's claim of the sort that we would like to discourage?

B. Plaintiff's Strategic Incentives

Given the ability to threaten the defendant with a penalty, the plaintiff would also like to make an offer within the *defendant target zone.* This zone would include all plaintiff settlement offers that the defendant found unacceptable and also presented a substantial risk of penalty ultimately being imposed on the defendant. The defendant will reject all settlement offers greater than his total expected liability. Thus, the defendant will reject all offers greater than $P_dJ + F_d + P_d(C_p+C_d)$. Let J^m = the plaintiff's expected maximum award. All plaintiff settlement offers greater than $P_dJ + F_d + P_d(C_p+C_d)$ and less than J^m fall within the defendant target zone.

There is nothing to guarantee that the defendant target zone is not empty. And even if it is not empty, there is, again, the problem that the plaintiff may do his cause more harm than good by trying to hit the target zone.

It should be noted, however, that the plaintiff does have an advantage over the defendant. The defendant may be unable to estimate J^m and may therefore make a high estimate to be on the safe side. In this case, the plaintiff will find it easier, than will the defendant, to create a credible threat of a penalty against the opposing party.

However, in general the implications are quite similar to those discussed in regard to the plaintiff. If the plaintiff's damages are largely certain, and observable to the defendant, the Modified British Rule will have no effect on tactical maneuvers. The rule will have its greatest impact when the plaintiff's maximum loss is difficult to observe and may be very large.

Is there an example of such a claim? Consider, again, the case of the lawyer offered a job by Smith & Smith. The extent of her loss depends on the likelihood that absent her former employer's discrimi-

nation, a bidding war would have broken out between her former employer and Smith & Smith. If such a war took place, who knows how high her salary may have been increased? As this example suggests, if there is uncertainty regarding the award, both above and below the expected award, the Modified British Rule may permit both sides to make target zone offers.

If, however, uncertainty is largely one-sided, the penalization threat of the Modified British Rule will be biased. *In particular, if the uncertainty largely concerns the difference between the mean and the minimum awards (i.e., the probability density of awards is skewed to the right), then the Modified British Rule will provide an advantage in litigation to the defendant.* The defendant will have a strong incentive in this case to make a settlement offer close the plaintiff's minimum, knowing that such an offer presents a penalization threat to the plaintiff. *Conversely, if the probability density of awards is skewed to the left, the Modified British Rule creates an advantage for the plaintiff. The rule operates neutrally, in generating target zones, in the case where the likely awards can be described by an evenly balanced, bell-curve shaped probability density.*

C. Timing of Offers

Suppose that the risks to the defendant of missing the plaintiff target zone are minimal. The defendant's optimal strategy is to attempt to make an offer in the plaintiff target zone. Should he do so at the very start? At the very end? To answer, this note that the penalty can be expressed as follows:

$$P_p(1\text{-}V_p)(F_d(t) + C_p(t) + C_d(t)) ,$$

where the variable t denotes the expected amount from the present to the end of the dispute. Thus, $F_d(t)$ represents the expected present value of the defendant's remaining litigation costs evaluated at date t. Since the costs decline as time advances (because the end of the legal dispute is coming near) we should assume the penalty is declining over time. This suggests that the defendant will prefer to make the settlement offer early, to maximize the impact of the penalty.

But this is not the whole story. The problem with an early offer is that is likely to be an uninformed offer. Suppose, for example, the defendant makes an early offer of $2.00 to settle the dispute. The plaintiff knows that he can easily prove damages of at least $200. In this case, the plaintiff will not worry about the possibility of a penalty; because if the plaintiff wins at all, he will certainly win a judgment in excess of $2.00. The offer of $2.00 may do nothing more than insult the

plaintiff, making it more difficult for the defendant to reach a mutually desirable settlement.

This suggests that the defendant, in order to reach the target zone, will have to take time to discover information concerning the plaintiff's likely judgment. If we assume that the defendant can gather sufficient information to identify the plaintiff target zone, then the optimal time for the settlement is the moment at which the benefits of information are just offset by the declining value of the penalty. In other words, the defendant will trade off an increase in the likelihood of the penalty being imposed (which is rising with more information) against the loss from erosion of the penalty over time. There may be disputes in which this optimal point is reached early, and there may be disputes in which it is never reached.

This analysis suggests that defendants will have incentives under the Modified British Rule to make early settlement offers in order to generate the risk of a penalty falling on the plaintiff. However, it also suggests that the routine charge that the Modified British Rule (and also Rule 68) creates incentives for defendants to make early low-ball offers may be wrong. A truly low-ball offer has no value to the defendant if it is below the minimum the plaintiff expects to receive given victory on the issue of liability. It probably will take time for the defendant to learn where the plaintiff target zone is, and this suggests that the problem of early low-ball offers has been exaggerated.

IV. ALTERNATIVES

Are there alternatives to the Modified British Rule that are preferable? To answer this it is useful, first, to recall why a majority of the current House of Representatives, an advisory committee of the Judicial Conference of the United States,[24] and several commentators have considered the proposed rule a good idea. There is a perception that there is an excessive amount of frivolous litigation, and that a number of plaintiffs, in particular, view the litigation system as a type of national lottery. The Modified British Rule has been proposed as a solution to this perceived problem.

One can question the claim that there is a problem that needs to be solved, and many have done so. The statistics do not indicate that the

24. Committee on Rules of Practice and Procedure of the Judicial Conference of the United States, Preliminary Draft of Proposed Amendments to the Federal Rules of Civil Procedure, 102 F.R.D. 407, 432 (1984).

total amount of litigation has increased greatly over the years.[25] Punitive damages, which some have claimed are responsible for recent growth in litigation, are awarded too infrequently to be an important incentive for attorneys to file suit.[26] Pain and suffering awards, however, are a different matter: they form an important component of many injury claims, and to the extent they are unpredictable, provide an incentive for plaintiffs to hold out for a large settlement. The Harvard Medical Malpractice Study provides a mixed picture of the tort litigation process.[27] Although relatively few medical malpractice victims file suit,[28] the quality of the claims filed is low.[29] In the end, it appears that the data do not allow us to say confidently whether frivolous litigation is a serious problem. In any event, I will assume here that it is a problem, though only in the interest of giving serious consideration to reform proposals.

One alternative to the Modified British Rule is to leave things as they stand. There seems to be a background belief, held by proponents of reform, that courts are at present incapable or unwilling to deter frivolous litigants. But federal courts in this country have long been understood to have "inherent powers" to penalize bad-faith litigants by shifting attorneys fees.[30] Of course, one might argue that there are still instances of frivolous litigation that may not quite reach the level of bad faith. But there are structural impediments to claims of this sort also. First, the fact that the plaintiff bears his own attorneys fees under the American rule has the effect of putting a floor on the level of merit a claim has to have before an attorney will accept it. A low merit claim is likely to be unprofitable for an attorney under the American rule. Second, a judge need not submit a frivolous claim to the jury and judges can set aside unreasonable jury verdicts. In short, it seems that the tools

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25. *See, e.g.*, Michael J. Saks, *Do We Really Know Anything About the Behavior of the Tort Litigation System — and Why Not?*, 140 U. PA. L. REV. 1147, 1196–1211 (1992); Marc Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4 (1983).

26. *E.g.*, Saks, *supra* note 25, at 1254–62; William M. Landes & Richard A. Posner, *New Light on Punitive Damages*, 10 REGULATION 33, (Sept.–Oct. 1986).

27. HARVARD MEDICAL MALPRACTICE STUDY, PATIENTS, DOCTORS, AND LAWYERS: MEDICAL INJURY, MALPRACTICE LITIGATION, AND PATIENT COMPENSATION IN NEW YORK, THE REPORT OF THE HARVARD MEDICAL MALPRACTICE STUDY TO THE STATE OF NEW YORK (1990).

28. *Id.* at 7.

29. In the Harvard Malpractice Study, one claim out of every six filed had been determined to have been the result of medical malpractice, see *id.* at 7–34; see also, A. Russell Localio, et al., *Relation Between Malpractice Claims and Adverse Events Due to Negligence*, 325 NEW ENG. J. MED. 245 (1991).

30. *See, e.g.*, *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 258–59 (1975).

are already there for courts to deter frivolous claimants.

However, the current system is not perfect. Although fees have the effect of putting a floor on the level of merit for the typical plaintiff's claim, this is not an unambiguous benefit for society. There may be many claims with a sufficiently high probability of success but without the features that we would typically associate with true merit. For example, a claim may have a high probability of success primarily because it has a good chance of benefiting from the ignorance and sympathies of a certain jury. Further, the fact that the American rule requires the plaintiff to pay his own fees creates a totally arbitrary floor on the level of merit. If litigation costs are high in a certain area, say because it is necessary to pay for the advice of experts, even plaintiffs whose claims have a high degree of merit may find their claims unprofitable.

An alternative that I find superior to the present system is the original design under common law courts. William Blackstone reported in the *Commentaries* that "costs were always considered and included in the quantum of damages, in such actions where damages are given; and . . . costs for the plaintiff are always entered on the roll as increase of damages by the court."[31] Costs, in Blackstone's terminology, refers to attorneys fees as well as court costs. In addition, parties were fined (amerced) at the court's discretion for litigating in bad faith;[32] defendants for unnecessarily delaying the judgment, plaintiffs for being frivolous claims. This original design was altered through a series of statutes controlling the discretion of courts to shift fees and impose fines, many enacted in an effort to control what was thought to be frivolous litigation.[33] However, the original system can be described as one in which there was a presumption that attorneys fees would be included as part of damages (i.e., "pro-plaintiff" fee shifting), and discretionary fines would be used to deter bad faith litigation.

Pro-plaintiff fee shifting coupled with discretionary fines strikes me as the most sensible system for encouraging claims with merit and discouraging frivolous litigation. I am unable to find a persuasive argument for allowing legal expenses to stand as an arbitrary barrier to valid legal claims. The litigation cost barrier faced by potential plaintiffs also provides a shelter to tortfeasors.[34] Knowing that litigation costs stand as

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31. 3 BLACKSTONE, COMMENTARIES *399.

32. 3 BLACKSTONE, COMMENTARIES *398.

33. *Id.* at 398–400.

34. Keith N. Hylton, *Fee Shifting and Compliance with the Law*, 46 VAND. L. REV. 1069 (1993).

a substantial obstacle to recovery by victims, potential injurers have less incentive to take care; and defendants have less incentive to admit fault and settle the dispute. Put another way, the allocation of litigation costs under the American rule permits defendants to start the race with a substantial lead.

In response to the problem of frivolous lawsuits, which would be encouraged by removing the cost barrier to plaintiffs, courts should have the discretion to impose fines against bad faith litigants, which may exceed the attorneys fees of the opposing party.

Rule 68, the Modified British Rule and similar proposals can all be viewed as efforts to erect a set of non-discretionary fines. Hence, an alternative that should be considered is the set of non-discretionary fine schemes that seem preferable to the Modified British Rule.

As another alternative, consider transferring the penalty to the state, as recently suggested with regard to Rule 68 by Chung.[35] The filing effect would remain, but it need not result in a decline in injurer incentives to take care or comply with the law. The reason is that the potential defendant would be burdened by the risk of having to pay a fine to the state, which increases compliance incentives. In the perfect symmetry case in which defendants and plaintiffs assign the same numbers to the relevant probabilities, there would be no effect on the incentives of injurers to comply. The interesting feature of this proposal is that the likelihood of settlement *increases* unambiguously. Suppose the defendant has made an offer in the plaintiff target zone. The plaintiff, knowing that a fine may be imposed, will reduce his settlement demand.[36] Under the Modified British Rule, the defendant would have simultaneously reduced his settlement offer. But if the fine is going to be collected, in whole or part, by the state, the defendant will not have an incentive to reduce his offer by the amount of the expected fine. Similarly, suppose the plaintiff makes the initial demand, and it falls in the corresponding target zone for the defendant. The defendant will have an incentive to increase his future settlement offers. The plaintiff will not have an incentive to increase his demands. To sum up, the two-way-state-imposed-fine scheme, unlike the Modified British Rule, is unlikely to reduce compliance incentives, and yet it also enhances the likelihood of settlement.

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35. Chung, *supra* note 3.

36. The probability of a fine being imposed will depend on the degree to which the plaintiff's claim can be characterized as one in bad faith. Thus, if the plaintiff has a sound claim, he will put a small estimate on the probability of a fine; consequently his settlement demand will not be significantly affected by the possibility of a fine.

Consideration of the two-way penalty with payment to the state permits us to see, indirectly, some of the wisdom of the common law design. The essential difference between this scheme and the common law system is that in the former the fine is non-discretionary while in the latter it is discretionary. But even if the fines are discretionary, the expected value of the fine is positive. This implies that the likelihood of settlement was greater under the common law system before the courts' discretion to impose fines was curtailed. In addition, since the common law fines varied with the degree of injury connected to the litigant's bad faith, they presumably had a deterrent effect on bad conduct. We have come to the point of seeing that the original design is probably superior to the Modified British Rule and to all of the statutory procedural modifications that have taken place since the year 1275.[37]

V. THE DEEPER PROBLEM

As the preceding discussion suggests, litigation reform is not a new topic. The path culminating in two-way fee shifting in Britain involved a number of statutory modifications designed in many instances specifically to control frivolous lawsuits. The general direction of legislative reform has been to restrict the discretion of courts, replacing inherent and discretionary powers, to shift fees and impose fines, with a set of rules authorizing and requiring the court to shift or not shift fees in this situation or that. It has been necessary to restrict the discretion of courts, in the eyes of reform proponents, because otherwise judges, left to their own devices, would make too many mistakes. They would fail to impose fines when they should, and this failure would in turn encourage frivolous litigation.

It is hard to know whether this argument is valid. If it is, then it implies that the heart of the problem is considerably deeper than a failure to sanction bad faith conduct in litigation. It means that judges have abandoned some of the most basic judicial responsibilities implicit in the design of common law courts. It should be considered beyond argument now that the common law requires courts to distinguish legal from factual claims, and to decide the former primarily on the basis of settled law.[38] It is also implicit in this scheme that there will be difficult

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37. The year of the Statute of Gloucester, which codified the rule of awarding costs to prevailing plaintiffs. *See* JOHN HULLOCK, LAW OF COSTS 4 (1793); William B. Stoebuck, *Counsel Fees Included in Costs: A Logical Development*, 38 U. COLO. L. REV. 202, 204–07 (1966).

38. I say "primarily" on the basis of settled law because there will inevitably be instances in which the settled rule is obsolete. In those instances, we expect common law courts to modify the rule to make it consistent with expectations.

cases in which the judge will have to apply his discretion to determine whether the issue is factual or legal, or indeed to identify the relevant legal rule.

However, if frivolous litigation is a serious problem, then courts must not be carrying out this responsibility. If frivolous claimants present a threat to defendants because they have a significant probability of success in court, then it must be that a significant percentage of judges are not using the tools they already have at their disposal to deny recovery to such claimants. If defendants are threatened by the prospect of a claimant seeking an unwarranted and extravagant punitive award, then there must also be a significant number of judges who fail to distinguish those cases in which punitive awards are appropriate from those in which they are not. And since it is the law that largely determines whether a plaintiff's claim has a weak legal foundation, or whether a punitive award is permissible, the failure of courts to adequately control frivolous litigation is at bottom a failure to render decisions in accord with law.

If this is an accurate description of the problem, then it must be recognized that rules restricting the discretion of judges, in managing the behavior of litigants, will not improve matters. The difficulties are attributable to a decline in the general competence of judges, not in the failure of rules to channel their conduct in the appropriate directions. A judge who makes questionable decisions because he fails to distinguish factual from legal issues cannot be made a better judge by forcing him to penalize litigants under certain conditions.

Again, if this description is accurate, the direction suggested by fee-shifting reform proposals is wrong-headed. Congress could make considerably more progress in reducing frivolous litigation by giving states incentives to raise the minimum qualifications of judicial candidates.

This would be particularly helpful in states in which judges are elected. Indeed, it is hard to imagine that frivolous litigation would not become a serious problem in those states in which the bench is elected. Stories are frequently related in the press of lawyers elected as judges, sometimes in place of qualified and experienced incumbents, solely because of the candidate's name or some other gimmick. This is a process that has a tendency to feed on itself. As the public becomes aware that judges are sometimes elected with substandard qualifications, they will adopt a less respectful view of the local judiciary. The best judicial candidates, aware that the general public has a dimmer view of judges, will not put their names forward to be considered for office. This process of adverse selection should continue until only the worst of minimally qualified candidates offer themselves as judicial candidates.

Within this incentive structure, the existence of frivolous litigation in certain courts should not be a surprise.

VI. Conclusion

My aim in this paper has been twofold: to present a careful analysis of the incentive effects of the "Modified British Rule," passed by the United States House of Representatives under the name of the Attorney Accountability Act; and to consider the implications of this analysis for civil litigation reform efforts in general. The Modified British Rule requires the court to shift post-offer fees and costs to the party who rejects a settlement offer and then receives a less favorable judgment from the court.

The rule would alter incentives by introducing nondiscretionary penalties. However, for the risk of penalization to materialize, the settlement offer must be within a certain target zone. For example, an offer from a defendant must be too low to be acceptable to the plaintiff and yet high enough to create a significant risk of penalization. While the penalty has been a subject of previous research focusing on Rule 68 and similar devices, this is the first paper to introduce the concept of the target zone, and to develop its implications. My analysis of the Modified British Rule penalty agrees with previous articles concluding that penalization in the Rule 68 context is unlikely to enhance settlement incentives generally. However, I find, unlike previous analyses, that the Modified British Rule penalty is likely to reduce incentives for plaintiffs to file suit and for potential defendants to comply with the law. Examination of the target zone suggests that the rule will be of little interest in some cases, because the target zone will be either too small or empty. In other cases, the probability distribution of court awards will introduce a bias in the incentives created by the rule, because the relevant target zone will be empty or too small to be of interest from the perspective of only one of the parties.

There are alternative schemes that are more likely to enhance the general settlement probability. For example, requiring the parties, under the Modified British Rule, to pay the penalty to the court would enhance post-offer settlement incentives. The pre-1275 design of common law courts, in which fees were routinely taxed against losing defendants and litigants were fined at the discretion of the court, is also an alternative that is probably superior, in its effect on settlement incentives, to modern schemes such as Rule 68 and the Modified British Rule.

Finally, I conclude that the use of nondiscretionary fee shifting as a method of controlling bad faith litigation is unlikely to improve matters. The tools needed to deter frivolous claimants are already in the hands of

judges. The reasonable inference is that frivolous litigation is a reflection of a failure to use those tools, and of the quality of judicial decisions. Nondiscretionary fee shifting schemes fail entirely to address these problems.