

GREATER JUSTICE,
LOWER COST:
How a “Loser Pays”
Rule Would Improve the
American Legal System

Marie Gryphon
Senior Fellow
Manhattan Institute for Policy Research

The United States struggles with a uniquely costly civil justice system. The direct costs of tort litigation, in particular, reached \$247 billion in 2006, or \$825 per person in the United States.¹ Moreover, tort costs in the U.S. as a percentage of gross domestic product are far higher than those in the rest of the developed world—double the cost in Germany and more than three times the cost in France or the United Kingdom.² The amount that is spent on tort litigation every year is greater than what Americans spend every year on new automobiles.

In addition to being overly expensive, American litigation is all too often inefficient and unfair. The fees and expenses incurred by lawyers on both sides of a lawsuit are almost as costly as transfer payments to plaintiffs claiming injury. Mass tort litigation, for example, over asbestos, has been exposed as rife with fraud. Small businesses are regularly besieged with nuisance suits that they must settle if they hope to avoid crippling legal costs. Last year's \$54 million lawsuit against a small Washington-area dry cleaner alleging that it had lost a pair of pants was remarkable not only for the astronomical damages claimed but also the almost \$100,000 in legal fees incurred in successfully defending against it. In American law, even when a defendant wins a lawsuit, he loses.

This study explores the likely effects of adopting a “loser pays” rule for attorneys’ fees in the United States. Loser pays, sometimes called the “English rule” but actually, in essence, the rule in place in the rest of the world, refers to the policy of reimbursement by the parties who lose in litigation of the winners’ legal expenses, including attorneys’ fees. This study argues that loser pays could be an important part of a larger effort to reduce litigation costs, better compensate prevailing litigants, and better align tort law with its goal of deterring socially harmful conduct. A loser-pays rule would discourage meritless lawsuits, but because any such rule should also ensure plaintiffs of modest means but strong legal cases access to justice, our proposal calls for:

1. A robust litigation insurance industry similar to those that now exist in other loser-pays countries; and
2. A cap on recoverable fees to eliminate the incentive that large litigants might have to attempt to “buy a verdict” under loser pays.

This study explores in depth how a loser-pays rule would change litigation in America. It includes key findings about the likely effects of loser-pays reform and evaluates previous experiments with loser pays in America.

THE STATUS QUO

This study delves into the available evidence about how the legal marketplace works, which lawyers file low-merit lawsuits, and how they stay in business:

- The subgroup of lawyers that file most nuisance lawsuits works to obtain settlements in weak legal cases before its members ever see a courtroom.
- The American system facilitates nuisance lawsuits, since the high cost of defending against weak cases gives defendants a strong incentive to settle.
- In contrast to nuisance suits, low-merit mass torts and class-action suits are able to attract some of the best lawyers in the United States because the potential damages stemming from these suits make them very lucrative, even when they are settled for a small fraction of the amounts demanded.

EFFECTS OF LOSER PAYS

This paper infers from its examination of the scholarly literature how loser pays would affect the American legal system:

- Almost every economist who has studied loser pays predicts that it would, if adopted, reduce the number of low-merit lawsuits.
- A loser-pays rule would encourage business owners and other potential defendants to try harder to comply with the law. Doing so should produce fewer injuries.
- Loser pays would deter ordinary low-merit suits, but it would not discourage low-merit class actions to the same extent because the risk of enormous losses, rather than the costs of legal defense, is the primary source of pressure on defendants to settle.

EXPERIENCES WITH LOSER PAYS

This paper reviews evidence from Alaska and Florida, two states that have had significant practical experience with loser pays:

- In Alaska, which has always had a loser-pays rule, tort suits constitute only 5 percent of all civil legal matters—half the national average.
- Between 1980 and 1985, Florida adopted a loser-pays rule that applied exclusively to medical-malpractice cases. This experiment was imperfect, drew criticism, and was ultimately dropped; but in significant respects, the Florida loser-pays rule seems to have worked to weed out weaker cases and facilitate case disposition: the rate at which medical-malpractice lawsuits were dropped after initial discovery rose from 44 percent to 54 percent of all such filings, and the percentage that proceeded to trial (instead of being dropped or settled) was half of what it had been under the American rule.

LITIGATION INSURANCE

This paper provides an overview of how litigation insurance would ensure access to justice for poor and middle-class plaintiffs under an American loser-pays system:

- In loser-pays jurisdictions, insurance covering the legal costs of the plaintiff can be purchased at the same time that a lawsuit is filed for a reasonable premium advanced by a plaintiffs' attorney as part of the ordinary costs of litigation.
- After recently scaling down its legal aid services, which were funding civil litigation for poor plaintiffs, England witnessed massive growth in its litigation insurance market; the same thing is likely to happen in the United States if it adopts a loser-pays rule.

To be successful in the United States, a loser-pays reform must be designed to reduce the number of nuisance lawsuits, control overall litigation costs, promote settlement, and ensure access to justice for plaintiffs with strong legal claims. To achieve these disparate goals within the existing American legal system, this new Manhattan Institute proposal incorporates a modified offer-of-judgment rule, which ties the amount of any fee award to the size of the parties' settlement offers, and advocates the removal of legal barriers to the establishment of a robust litigation insurance industry in new loser-pays jurisdictions.

ABOUT THE AUTHOR

MARIE GRYPHON is a Senior Fellow with the Center for Legal Policy. As an attorney in private practice, she worked on ERISA, securities, class action, commercial contract, legal malpractice, and constitutional law cases. She has also been a legal and policy analyst with the Cato Institute, working on issues related to education policy. Her articles have appeared in *The Washington Post*, *Forbes*, and National Review Online. She holds a J.D. from the University of Washington School of Law and is a Ph.D. candidate in public policy at Harvard University.

ACKNOWLEDGMENTS

Sincere thanks for helpful comments are due to Ted Frank, Michael Krauss, Robert Levy, Clark Neily, Walter Olson, and Alexander "Sasha" Volokh, and to Gabriel Cahn for valuable research assistance, none of whom should be assumed to be in full accord with this report and none of whom bears responsibility for any errors or omissions.

The author would like to thank also the Cortopassi Institute and Paul Singer for generous financial support.

Findings presented in Manhattan Institute publications are those of our scholars and are not influenced by the individuals, foundations, and corporations that support the Manhattan Institute and its research.

CONTENTS

1	Introduction
2	Part I: Reforming a Costly System
4	Part II: The Status Quo
	Figure 1
	Figure 2
	A Model of Defendants' Collective Action Problem
7	Part III: What to Expect from Loser Pays
	Figure 3
	Figure 4
	Figure 5
	A Compliance Model
13	Part IV: Loser Pays in Action
	Figure 6
	Figure 7
	Figure 8
16	Part V: Preserving Access through Insurance
18	Part VI: Implementation Guidelines
18	Part VII: A Proposal for Reform
20	Appendix
	Formal Model of Loser-Pays Proposal
21	Endnotes

A PRINCIPLED PROPOSAL FOR TORT REFORM

By Rudy Giuliani

America needs tort reform, and this new report published by the Manhattan Institute is an important part of the road map leading us there. Civil litigation consumes 1.87 percent of America's gross domestic product, roughly twice that of almost all other industrial countries. The price tag for a family of four came to \$3,300 in 2006.¹ Only 16 percent of Americans say they trust our civil justice system "to defend them" if someone should bring a baseless lawsuit against them.² This is evidence of a broken system that needs to be fixed.

Here's just one example of the real cost of abusive lawsuits. A family dry cleaning business was recently dragged through two years of litigation by a customer seeking \$54 million as compensation for a lost pair of pants. To make matters worse, the person who brought this irresponsible lawsuit was a judge. Though the case was dismissed, the dismissal is now being appealed, and the cleaning business's legal costs so far have been almost \$100,000.

In the health-care industry, many doctors report ordering unnecessary tests to avoid lawsuits—in Pennsylvania as many as 93 percent of doctors have—costing up to \$100 billion annually. Doctors call this "defensive medicine." I call it a "trial lawyer tax."

To reduce the impact of the trial lawyer tax, we should reform the system by adopting rules that discourage meritless lawsuits—rules such as "loser pays," which is well articulated in Marie Gryphon's timely report for the Manhattan Institute. Gryphon's proposal is recommended reading for policy analysts, and food for thought for more casual observers, as the issue of meritless lawsuits becomes even more urgent and in need of real solutions.

At its core, loser pays seems fair. Under the current, American rule, each party to a lawsuit pays its own legal bills, win or lose. Because it's so expensive to go to court, someone who is sued loses even when he wins, as the family dry cleaners found out. Knowing that the rules are stacked against them, defendants settle meritless claims, and these settlements in turn fuel baseless new cases. For example, the dry cleaner offered \$12,000 to settle the case against it—a sum far higher than the actual replacement cost of the pants.

Loser pays, while unfamiliar to many Americans, is not a radical idea. It is the rule in virtually every other developed nation, across all of Western Europe as well as Canada and Australia.

While loser pays would help stem the tide of lawsuit abuse, it isn't a cure-all. We also need to establish limits on punitive and non-economic damages, which are too often used to turn the legal system into a lottery. The possibility of winning millions or even billions of dollars encourages attorneys to file lawsuits with a low probability of success.

In Texas, lawmakers and voters adopted a \$250,000 cap on non-economic damages such as pain and suffering in medical malpractice cases. The law dramatically reduced doctors' malpractice insurance premiums and cut in half the number of lawsuits against them. Now, a flood of doctors is moving to Texas in order to escape the unnecessarily high cost of doing business elsewhere.

The integrity of our legal system is under assault. Establishing loser-pays rules and other tort reforms can help restore citizens' faith in the bedrock of society—justice, fairness and the rule of law.

¹ Towers Perrin, 2007 Update on U.S. Tort Cost Trends, p. 3.

² Harris Interactive, "Public Trust of Civil Justice," June 20, 2005.

GREATER JUSTICE, LOWER COST: HOW A “LOSER PAYS” RULE WOULD IMPROVE THE AMERICAN LEGAL SYSTEM

Marie Gryphon

I. INTRODUCTION

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.³ While all litigation is costly, this paper will focus on the high cost of “abusive litigation”: litigation filed by a plaintiffs’ attorney who has good reason to believe that he is legally in the wrong but who sues anyway in order to exact revenge or coerce a settlement from the lawsuit’s target.

The purpose of this paper is to explore the possibility of reducing the incidence of abusive litigation in the United States through the adoption of a loser-pays rule. Part I of this paper reviews evidence of the high cost of the current system; summarizes the state of the debate between proponents and opponents of loser pays; and proposes standards for the evaluation of legal procedural reforms. Part II describes the current state of the legal marketplace and how some of its participants profit from abusing it. Part III summarizes the best theoretical research into what kinds of effects we could expect loser pays to have on litigation. Part IV builds on the hypotheses developed in Part III by examining evidence from overseas as well as from two

important loser-pays regimes here in America. Part V explores the possibility of preserving access to justice for plaintiffs with strong lawsuits through a system of litigation insurance. Part VI offers guidelines for loser-pays reform implementation. Part VII provides a final loser-pays reform proposal and states our conclusions.

PART I: REFORMING A COSTLY SYSTEM

The United States struggles with a uniquely costly civil justice system. The direct costs of tort litigation—including payments to plaintiffs, legal expenses and fees, and the administrative cost of insuring the system—reached \$247 billion in 2006. Moreover, tort costs have grown more quickly than the rest of the U.S. economy, rising at an average annual rate of 9.2 percent between 1951 and 2006, a period during which GDP grew at an average rate of only 7 percent.⁴

The \$54 million claim that Washington, D.C., administrative judge Roy Pearson filed against his local dry cleaner last year typifies the problem of abusive litigation in the eyes of millions of Americans.⁵ Pearson's allegation: that Jin and Soo Chung had lost a pair of trousers that he had left at the store for alterations. Not only had the Chungs failed to alter and return his pants, Pearson claimed; they defrauded him and other D.C. residents by posting a sign in their window reading "satisfaction guaranteed," for which the Chungs should pay millions of dollars in noneconomic and punitive damages and (though Pearson represented himself) attorneys' fees.⁶

The Chungs' lawyer knew that Pearson's legal arguments were as specious as his damages claims were outrageous. Nonetheless, he advised the Chungs to offer Pearson \$12,000 to settle the case—far more than the value of the pants—since he knew that the costs of defending the case would be high. Pearson declined this generous settlement offer and litigated his case so aggressively that the Chungs eventually owed almost \$100,000 in legal fees.⁷ Unsurprisingly, Pearson lost at trial, and extensive media coverage galvanized public support for the Chungs, who received donations to cover their legal bills.⁸

Still, the Chungs had been damaged both emotionally and financially, since Pearson had aggressively advertised his complaints to the neighborhood in an effort to find other unsatisfied customers, and business had dropped off as a result. The Chungs shut down the store that Pearson had patronized and laid off staff members.⁹ The Chungs were forced to return full-time to the smaller store, Happy Cleaners, where they had started their business.¹⁰ And the Chungs' ordeal is not yet over: Pearson has appealed the ruling against them.¹¹

The so-called pants suit of 2007 was extraordinary in the frivolousness of its claims and the amount it demanded.¹² But abusive litigation—lawsuits against defendants who are known to be, or expected to be found, innocent of legal wrongdoing—is tragically common. Most such cases settle for a few thousand dollars, but the time lost and stress inflicted far surpass that amount.¹³ The Chungs reported finding it difficult to return every day to the dry-cleaning store that Pearson had patronized.¹⁴ Other small-business owners report feeling less trustful of employees and customers after being sued.¹⁵

Though determining the exact breakdown of all lawsuits nationwide is difficult, the proportion of litigation targeting small businesses is sizable, between 36 and 52 percent of all lawsuits filed against businesses, according to the Klemm Analysis Group.¹⁶ Moreover, suits against small firms are expensive: of the approximately 30,000 small businesses sued in 2002, two-thirds spent more than \$10,000 in attorneys' fees in addition to any settlement or judgment.¹⁷

Large businesses are frequently sued, but they expect, and are able to budget for, a certain amount of litigation every year. For small businesses, by contrast, litigation, and especially its associated legal fees, is a shock that can make it suddenly impossible for them to meet their ongoing financial obligations.¹⁸ Small-business owners say that they are reluctant to recoup their litigation losses by raising prices because price increases risk hurting their competitiveness.¹⁹ Klemm reports: "Owners mentioned that the payment of damages nearly put them out of business."²⁰

Debating loser pays

Some legal reformers advocate replacing the American rule for attorneys' fees with a loser-pays rule in order to reduce the high costs of litigation—especially abusive lawsuits. Under the American rule, each party to a lawsuit must bear the cost of his own legal representation, win or lose. Virtually every other civil justice system in the world has a loser-pays rule (sometimes called the English rule in American legal circles) for attorneys' fees, under which the loser in a civil suit must cover the reasonable legal expenses of the winner.²¹

The American rule makes the civil justice system as a whole unnecessarily costly by encouraging the filing of dubious 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 victories for defendants Pyrrhic ones. As Professor Jon Langbein told ABC News'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."²² Our legal system would be more equitable if it required an unsuccessful plaintiff to compensate a prevailing defendant.

Our present system can be just as unfair to a deserving plaintiff. 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 and litigation costs paid by the plaintiff frequently soak up 40 percent or more of any judgment or settlement. Also, potential plaintiffs with injuries that are significant but worth less than their lawyers' cost of going to trial can be denied access to justice entirely.

Despite these defects, the American rule has a large cadre of 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.²³ Those not so deterred could still be induced by veteran defendants to settle for far less than their claim is worth.²⁴ Thus, these critics say, compensation under a loser-pays rule is usually only partial, just as it is under the American rule, for a plaintiff who settles.²⁵ The benefits of a loser-pays rule will not become evident unless its advocates deal with such concerns.

Goals of Procedural Reform

What can we all agree that we want from our system of justice? The following four goals reflect widely shared values about how procedural rules of law should function, regardless of the underlying substantive law. This paper will evaluate the American rule and the alternatives to it on the basis of how well they serve these four very general and widely endorsed criteria. If a loser-pays reform proposal is superior to the American rule on those grounds, it should command broad support.

Compliance with the Law

Procedural reforms should have the effect of promoting compliance with the law. Although the merits of specific substantive legal rules might be debatable, if a body of law is generally just, the premise that procedural rules ought to promote legal compliance should be uncontroversial.

Compensation for Victims

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 at the expense of the injurer. We may disagree about how costly such reparation must be before it becomes unduly punitive, but this paper will assume that full compensation for wrongful injuries is generally a desirable goal of procedural reform.

Low Transaction Costs

If a given procedure can uphold 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.

Equitable Distribution of Costs

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. Costs are equitably distributed, in this view, if they are borne by the wrongful parties or, to the extent that they are not, if they are shared by the society that benefits from the existence of a system of civil justice.

PART II: THE STATUS QUO

Reporting on frivolous litigation tends to focus on the most outrageous claims, often involving enormous sums of money, such as the multimillion-dollar lawsuit against the Chung's dry-cleaning business previously described. The media also report on cases in which plaintiffs are awarded large sums for injuries they suffered after assuming commonly understood risks, as was the plaintiff who was served a hot cup of McDonald's coffee that she promptly spilled, scalding herself.²⁶ Other kinds of suits that get major press attention are typically class actions or government-led claims that target companies for, among other things, selling high-calorie foods or violent video games.

Such cases get media attention because they involve particularly bizarre claims, colorful characters, or millions of dollars. 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 we pay for groceries, automobiles, health 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 I

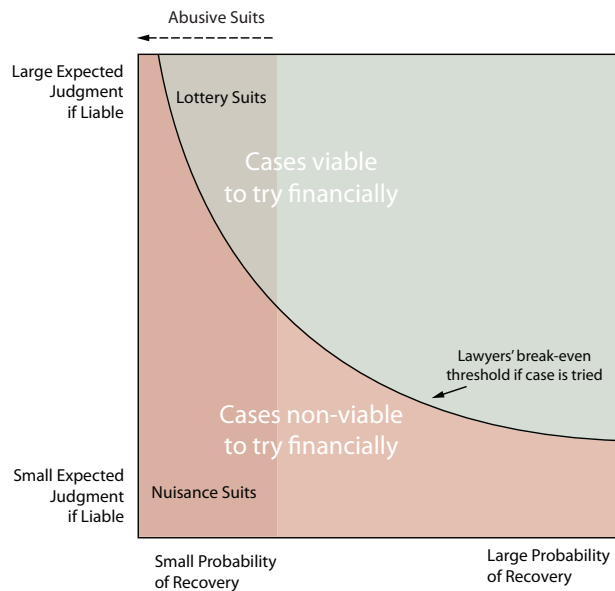


Figure 1 depicts the litigation universe in two dimensions by holding the number of hours worked constant. The curved line represents a contingent-fee lawyer's financial break-even point (or "opportunity cost") for a given case, assuming that it goes to trial. The higher the stakes are, the lower the legal merit of a case could manage to be while still offering a lawyer an economic incentive. The most profitable cases are located at the top right corner of the figure.

"Abusive lawsuits"—represented by the shaded area on the left in Figure 1—have little legal merit, regardless of the magnitude of the recovery sought. "Lottery suits" 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 simply because there is so much money at stake that a contingent-fee lawyer can make a good living by winning only a small minority of them.

Professor Herbert Kritzer of the University of Wisconsin Law School describes the practices of three law-

yers who can be located in 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.”²⁷ 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,²⁸ characterized by modest stakes and little legal merit. They 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.

Who Files Nuisance Suits?

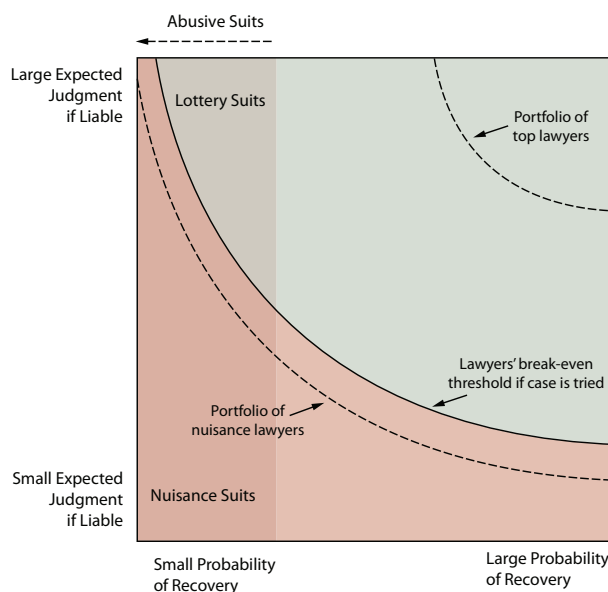
We usually imagine that nuisance suits are filed by struggling lawyers operating alone or in a small firm, “chasing ambulances” or otherwise aggressively marketing their services to disoriented or hesitant clients. We don’t think of them as being filed by the kinds of lawyers who labor at complex, multiyear 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.²⁹

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.³⁰ 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. As a result, successful lawyers (who can be extremely selective about the cases they take) accept only those cases that can produce very high effective hourly compensation. Zamir and Ritov write: “[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.”³¹

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.³² There is also evidence that an elite subset of lawyers is able to attain exceptionally high effective hourly rates through careful selection of cases.³³ Figure 2 illustrates how, according to Zamir and Ritov, cases and lawyers are matched.

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’s.

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: "The lawyer can be relatively non-selective. 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."³⁴

The two great exceptions to the rule that struggling lawyers file dubious suits are low-merit mass torts and class action suits. These kinds of cases concern hundreds or thousands of similarly injured plaintiffs and are usually settled *en masse*. Because these cases require lawyers to spend little or no time on any individual claim, they offer enormous efficiencies of scale, making them attractive to the most elite members of the plaintiffs' bar, even if each individual case would have little value on its own.³⁵

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 do sometimes 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.³⁶ 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 to lawyer and economist Lu-

cian Bebchuk.³⁷ 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.

Plaintiffs' lawyers who file nuisance suits may also be helped by ethics rules that prohibit them from withdrawing from cases if doing so would impose a substantial hardship on a client.³⁸ While lawyers may sometimes refuse to try cases if a plaintiff has "unreasonably refused" a settlement offer, such refusal must be contrary to the plaintiff's self-interest, not the lawyer's.³⁹ 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.

Bebchuk and Andrew T. Guzman have shown that contingent-fee arrangements enhance the pre-trial bargaining power of plaintiffs by relieving them of almost all of the considerable costs of going to trial, which are borne by the contingent-fee attorney and, of course, the defendant.⁴⁰ (Plaintiffs' bargaining power would be diminished if ethics rules allowed plaintiffs' lawyers to drop cases that do not settle.)

Still, if a distinct class of lawyers is responsible for most nuisance litigation, it should be theoretically possible for defendants to identify the class's members and systematically refuse to settle the cases that they file—at least those cases that do not demand an unusually costly initial response or whose outcome is not highly uncertain. Presumably these lawyers would stop filing such cases, since they would not be lucrative enough to justify the cost of going to trial.

This has not happened, however, because, in what is known as a collective-action problem, defendants cannot count on each other to litigate every nuisance claim. Therefore, at least some settle. The nuisance lawyers are able to use the proceeds to pursue other blameless defendants, which also settle, since they know that nuisance lawyers have the means to go forward in the face of a refusal to settle (see box). Thus, settlement of nuisance suits is the norm under the American rule. Indeed, the empirical literature shows that the United States has developed a culture

of nearly universal settlement.⁴¹ Only about 7-9 percent of lawsuits filed actually proceed to trial.⁴² Lawyers and policymakers praise high settlement rates because settlement avoids the public and private expenses of a trial. Still, it must be acknowledged that the certainty of trial would keep some number of suits from being filed.

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.⁴³ A reduction would occur because defendants would be unwilling to pay as much to settle them as they currently do.

A MODEL OF DEFENDANTS' COLLECTIVE ACTION PROBLEM

Defendants in nuisance suits filed by a single nuisance lawyer or firm face a classic collective action problem often referred to as the “Stag/Hare game.” Here it is in reduced form:

		Defendant 2:	
		litigate	settle
Defendant 1:	litigate	best, best	worst, middle
	settle	middle, worst	middle, middle

If all defendants refuse to settle nuisance suits, they will drive the nuisance lawyer out of business: the best outcome. But if some defendants settle, those who do not settle will incur trial expenses unnecessarily: the worst outcome. There are two Nash equilibriums in this game: [litigate, litigate] and [settle, settle]. However, [litigate, litigate] is not “trembling hand perfect.” That is: universal litigation is not a stable equilibrium in this game if the players occasionally make errors. Therefore only [settle, settle] survives dominance refinement analysis and is the expected equilibrium in this game.

For general background, see Douglas G. Baird, Robert H. Gertner and Randal C. Picker, *Game Theory and the Law* (Cambridge: Harvard University Press, 1994), p. 36.

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 very 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 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.⁴⁴ 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 should 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-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

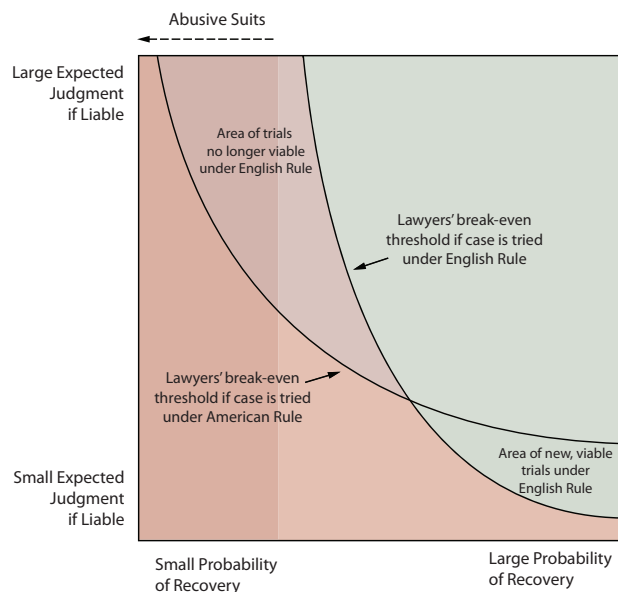
In addition to reducing the number of nuisance suits, a loser-pays rule should increase the viability of small, highly meritorious lawsuits that cannot be profitably tried in the current system, a point on which most researchers agree.⁴⁵ Figure 3 illustrates how a loser-pays rule would shift the break-even line for suits taken to trial and therefore, by inference, the viability of all meritorious suits, including those that settle.⁴⁶

The increased viability of small, meritorious claims would have costs as well as benefits. On the one hand, a person with a modest but meritorious claim should be compensated. Critics of loser pays who worry that the rule would limit access to the courts often fail to acknowledge that the American rule essentially eliminates 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 could keep the overall amount of litigation from going down, and thus the overall cost of administering the legal system.

There is reason to think that the reduction in nuisance suits following the adoption of loser pays would be greater than the increase in small, highly meritorious claims. 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. Also, many small claims are currently litigated as class actions.

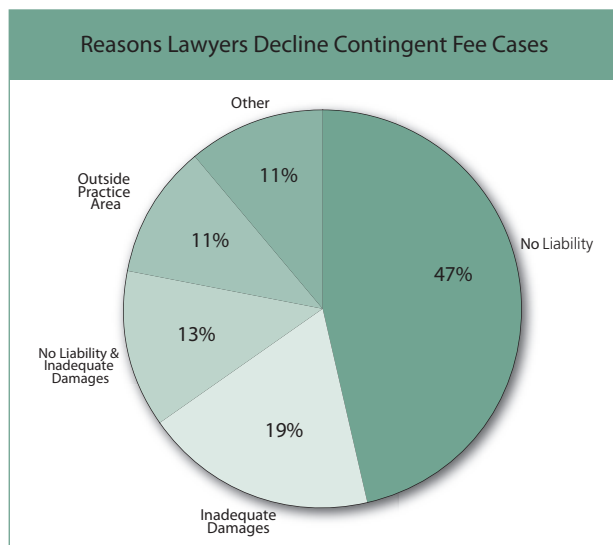
Figure 3



Responses from Kritzer's survey of contingent-fee lawyers in Wisconsin suggest that the number of nuisance filings deterred under a loser-pays rule would be larger than any increase in the number of small, meritorious cases filed. Figure 4 shows how prevalent are the various reasons that contingent-fee lawyers give when they decline a case. It shows

that in 46 percent of the cases declined by the surveyed lawyers, there was, in their view, a low probability of a finding of liability. Only 19 percent were declined because the expected size of the recovery was too low.⁴⁷

Figure 4



Herbert M. Kritzer, *Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States* (Stanford, CA: Stanford University Press, 2004), Table 3.9.

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 little legal merit than have merit but promise only modest recoveries.⁴⁸ If that is so, the largest category of case that loser pays discourages should be that of low-merit cases.

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 in small ways. Loser pays may therefore be more likely to promote immediate, and appropriate, handling of small injuries than to trigger a tide of small suits. Under the American rule, defendants are more likely to treat many small, high-merit claims as no different from nuisance claims and under-compensate genuinely injured victims, since they know that it is un-

profitable for plaintiffs' lawyers to litigate such cases to trial.⁴⁹

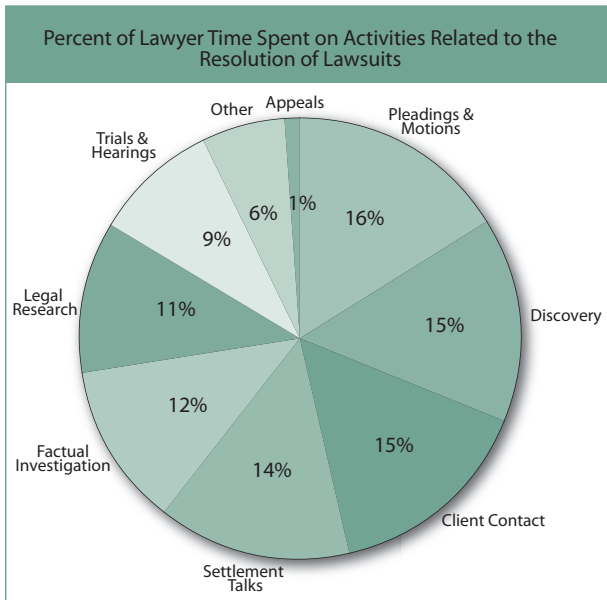
Settlement Rates

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.⁵⁰ 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.⁵¹ On the other hand, higher stakes could induce risk-averse parties to settle.⁵² 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,⁵³ while two older experiments suggest that settlement rates would increase.⁵⁴

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 7–9 percent of lawsuits filed go to trial.⁵⁵ The rest are resolved by settlement, by dismissal or summary judgment, or by the plaintiff's decision to drop the suit.

In part because so few cases proceed to trial, most resources devoted to litigation are spent at its earlier stages, including settlement negotiations. Figure 5 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 9 percent 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.

Figure 5



David M. Trubek, Austin Sarat, William L. F. Felstiner, Herbert M. Kritzer and Joel B. Grossman, "The Costs of Ordinary Litigation," *U.C.L.A. Law Review* 31 (1983-84): 72-127, Table 3.

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 high. Nonetheless, a loser-pays rule 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.⁵⁶ 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 losing the case. 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 bear only \$500 of the additional \$1,000 spent.⁵⁷ 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.

While this "cost-internalization" critique of loser pays is not without merit, the charge that loser pays would generally increase costs per case is less than convincing, closer analysis reveals. A party's decision to increase spending on litigation under loser pays reflects not merely its expectation that such spending will improve its odds of success at trial. It reflects as well what it understands to be the odds that such spending will encourage additional spending by the other side, and it reflects a view as to how different amounts of additional spending by both sides are likely to affect either side's chances of winning or losing at trial.

All studies that predict higher per-case expenditures under loser pays than under the American rule assume that a party that spends more on litigation increases its chance of prevailing, especially if the opposing party does not match those expenditures. But, in reality, a loser-pays rule would not necessarily motivate either party to spend more. Rather than increasing a party's chance of success at trial, much legal spending may be what economist Avery Katz calls "provocative expenditure,"⁵⁸ spending that merely induces the opposing party to respond with additional spending of its own. While Katz argues that loser pays would increase trial expenditures, his argument assumes that legal spending is not provocative. If it were, his doubts about loser pays would, he concedes, be misguided.⁵⁹

In fact, most decisions to spend money on litigation *are* provocative because they trigger a litigation event, such as a motion, discovery request, or pretrial conference, that requires the opposing party to undertake a costly activity in response.⁶⁰ Serious analysts of the legal system, even those who typically defend the status quo, admit as much. For instance, Kritzer notes that lawyers' efforts in litigation are "largely determine[d]" by "the actions of the opposing party."⁶¹ He adds: "Each 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."⁶²

Empirical analysis supports what theory would predict. Data from the Wisconsin Civil Litigation Research Project confirm that in litigation conducted under the American rule, 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 simplistic hypothesis embraced by critics of loser pays that parties under such a regime will keep spending more in order to improve their chances of prevailing.⁶³

Practically speaking, there is reason to believe that it has been the American rule that more often provokes increased legal spending per case, due to the provocative nature of legal expenditures, particularly at the pretrial stage. Plaintiffs’ attorneys in the United States bury defendants in onerous discovery requests, knowing that their clients bear none of the costs of document production; the cost of discovery itself increases cases’ settlement value. Similarly, defendants flood plaintiffs with motions; regardless of the motions’ probability of success, the expected settlement value of the case falls, given the costs that plaintiffs must incur in responding and that they might seek sooner rather than later to avoid. Because motions and particularly discovery requests are far cheaper to draft than the responses they trigger, the American rule promotes provocative legal spending. A loser-pays rule would discourage it.

Thus, there is reason to believe that a loser-pays rule would not generally increase litigation expenditures per case very much and may, indeed, have the opposite effect. Nevertheless, under at least some conditions, the critics’ concern that loser-pays rules would encourage higher spending is well-founded. For instance, a party that estimates its probability of success to be very high might refuse reasonable settlement offers and run up costs, confident that the other side will end up bearing those costs. While judicial fee reviews are the means by which other countries’ loser-pays systems deter such tactics, an American loser-pays reform could best deal with such tactics by relying on offer-of-settlement rules already in place in most states. Such rules encourage settlement by reducing recovery if the ultimate judgment does not exceed an earlier, rejected offer by a substantial margin.

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 comply with the law.⁶⁴ In effect, loser pays makes innocence cheaper and legal culpability more expensive, disposing a potential wrongdoer to spend additional resources on ensuring the blamelessness of its behavior. Loser pays does so by simultaneously lowering the cost of law-abiding behavior and raising the cost of negligence, as the following example illustrates.

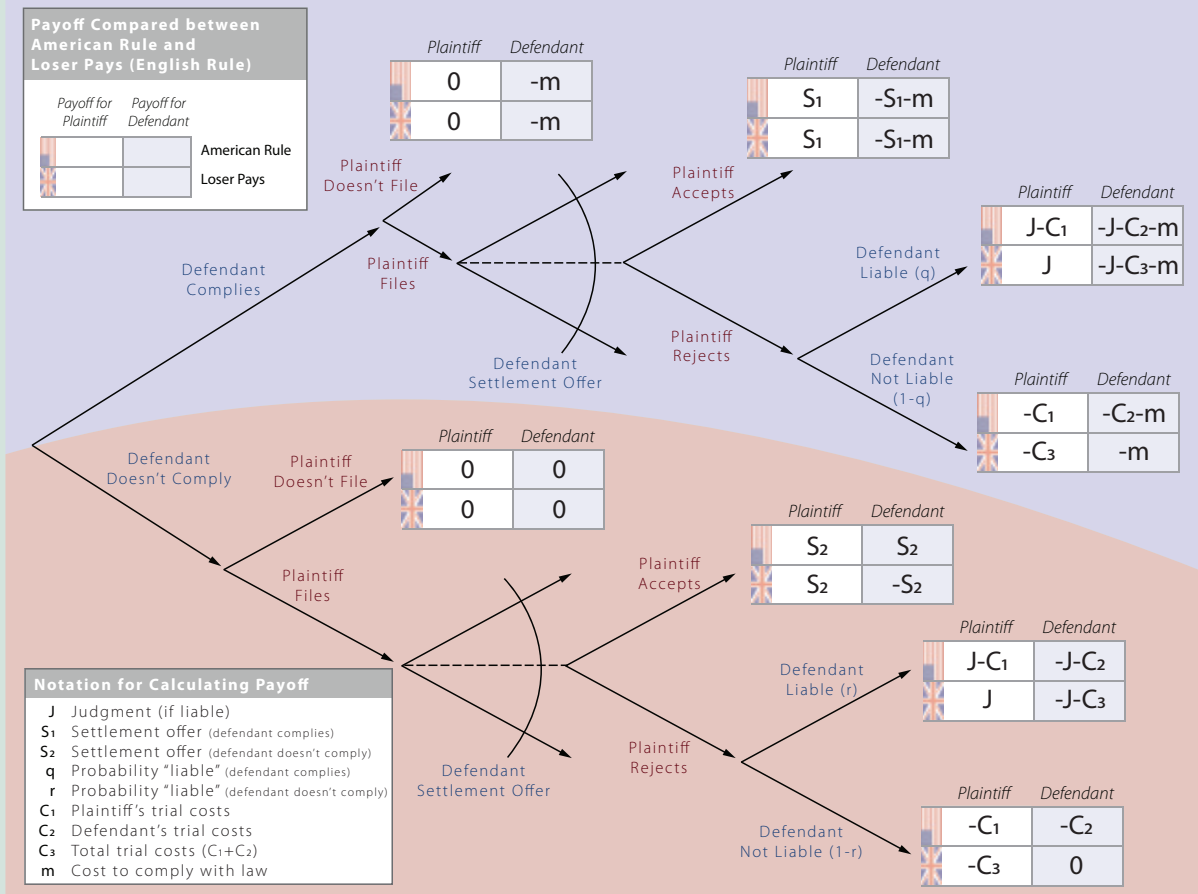
Like most successful shopkeepers with many daily customers, shopkeeper Susan occasionally faces lawsuits from customers who slip and fall on her property. Susan learns that she can install a new, nonskid surface on her front steps at a cost of \$600. She predicts that if she installs the surface, she will have a 75 percent chance of winning at trial the next time she is sued. If she does not install the surface, she predicts that she will have only a 25 percent chance of prevailing at trial. On the basis of her personal experience and local news reports, she predicts that a trial would cost her about \$300 in legal fees, and a judgment against her \$1,000.

But Susan soon discovers that under the American rule still prevailing, an investment in safety would not pay. If she installs the surface, a lawsuit would cost her an expected \$550 (legal fees of \$300 plus a 25 percent chance of losing the case and paying a \$1,000 judgment) if she went to trial. She would therefore be willing to pay a plaintiff almost that much to settle the case. If Susan does not install the surface, a lawsuit would cost an expected \$1,050 (legal fees of \$300 plus a 75 percent chance of paying a \$1,000 judgment), and she would be willing to pay almost that much to a plaintiff to settle the case. Under the American rule, therefore, she has no financial incentive to make a \$600 investment in customer safety that yields a benefit of only \$500.

Under a loser-pays rule, Susan would make a different calculation. If she installs the nonskid surface, a

A COMPLIANCE MODEL

The decisions of the plaintiff and defendant in a civil case can be represented in a simplified form by a game tree. Comparing the defendant's payoffs under the American rule and under a loser-pays rule shows that a rational defendant will devote more resources to complying with the law in a loser-pays system.



In this simple model, a potential defendant must decide whether to take a specific action at some fixed cost in order to comply with the law. This model assumes that courts sometimes make errors but that they are correct more often than not when they determine whether a defendant has been negligent. That is, it assumes that: $1 > r > .5 > q > 0$. A defendant can minimize its expected costs by spending up to m in order to comply with the legal standard of care. To determine the optimum values of m under the American rule and loser pays, we can set the defendant's expected costs for compliance and noncompliance at trial as equal to each other:

Finding optimal compliance expenditure under the American rule yields:

$$q(-J - C_2 - m) + (1 - q)(-C_2 - m) = r(-J - C_2) + (1 - r)(-C_2) \Rightarrow m(\text{American})^* = J(r - q)$$

Finding optimal compliance expenditure under a loser-pays rule yields:

$$q(-J - C_3 - m) + (1 - q)(-m) = r(-J - C_3) + (1 - r)(0) \Rightarrow m(\text{loser pays})^* = J(r - q) + C_3(r - q)$$

Because we know that $r > q$, we can see that $m(\text{American})^* < m(\text{loser pays})^*$. That is, a defendant will invest more resources to comply with the law under a loser-pays rule than he will under the American rule. An additional benefit to both prospective plaintiffs and prospective defendants not reflected in this simple model is that, if the prospective defendant complies with the law, the potential plaintiff's injury and subsequent lawsuit are less likely to take place.

lawsuit would cost her an expected \$400 (a 25 percent chance of paying the sum of \$1,000, the amount of a judgment, and \$600, the legal fees of both parties), and she would be willing to pay nearly that much to settle. If she fails to install the surface, a lawsuit will cost her an expected \$1,200 (a 75 percent chance of losing and paying both a \$1,000 judgment and \$600 for the legal fees of both parties), and she would be willing to pay nearly that much to settle. Under loser pays, therefore, Susan would be happy to pay \$600 to install the nonskid surface because doing so would save her an expected \$800 the next time she is sued.

In the real world, compliance and investment decisions are far more complicated than this simple narrative suggests. For example, an investment in safety equipment might reduce the frequency with which a defendant is sued, as well as improve his chances of prevailing at trial. Even in the absence of such considerations, loser pays gives people and businesses incentives to try harder to meet legal standards.

Economist Keith N. Hylton estimated the effect of a loser-pays rule on legal compliance. 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.⁶⁵ 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.⁶⁶

Hylton also attempted to determine which of four alternative fee-shifting rules maximized overall social welfare by adding up the costs of injury, compliance, and litigation under alternative regimes. Hylton found that litigation costs rose under loser pays because fewer cases settled, but that those increases were dwarfed by the welfare-enhancing effect of greater compliance with the law. Hylton concluded that loser pays did better than alternatives, including the American rule, at conserving resources and avoiding injuries.⁶⁷

PART IV: LOSER PAYS IN ACTION

America's litigation habit far exceeds that of other nations. The share of our economy spent on litigation is at least twice that of Germany's, France's, England's, and Northern Ireland's.⁶⁸ It is perhaps not coincidental that America is also nearly alone in clinging to the American rule. Nonetheless, it is difficult to determine to what extent the American rule is to blame. As Judge Richard Posner has observed, it is very difficult to conclude from levels of litigation in Europe and elsewhere what effect a loser-pays rule would have here in America, because the huge variety of other ways in which nations and their legal systems differ may affect the amount of litigation they experience.⁶⁹

But international comparisons usefully refute claims that loser pays cannot work well with other features of

Figure 6

Country	Direct Tort Litigation Costs as a Percentage of GDP (2003)	Loser Pays?	Class Action Mechanism?	Civil Jury Trials?	Contingent or Conditional Fees?
U.S.A.	2.2	no	yes	yes	yes
Canada	0.8	yes	yes, in some provinces	yes, in some provinces	yes
England / No. Ireland	0.7	yes	no	almost none	yes
Germany	1.1	yes	no	no	in some cases
France	0.7	yes	no	no	yes
Australia	1.1	yes	yes	yes, in some states	in some cases

the current American system, such as contingent fees, civil jury trials, and class action mechanisms. In fact, as Figure 6 shows, other nations with these features have combined them successfully with loser pays, as evidenced by their far lower rates of litigation.

Indeed, to assess the compatibility of loser pays with the rest of U.S. law, it is not necessary to look abroad. Alaska has always had a loser-pays rule, and Florida once applied a loser-pays rule to medical-malpractice suits.

The Alaskan Experience

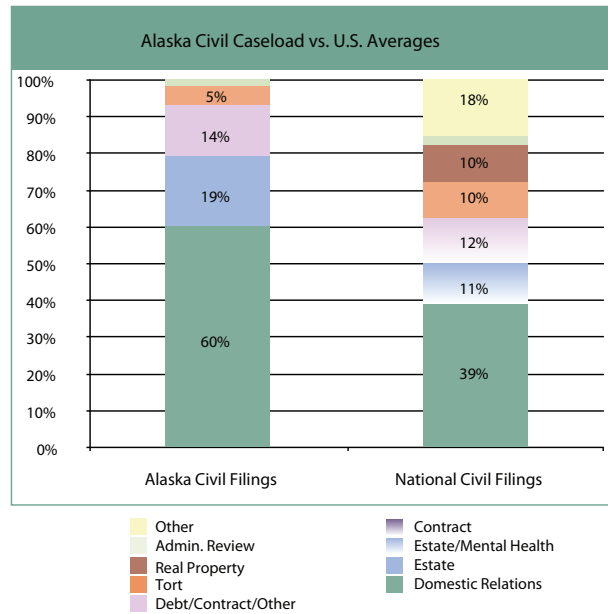
Uniquely among the states, Alaska has had a nearly universal loser-pays rule since 1884, well before statehood. Alaska’s Civil Rule 82 provides: “Except as otherwise agreed to by the parties, the prevailing party in a civil case shall be awarded attorneys’ fees calculated under this rule.” The rule calculates fee awards for plaintiffs as a percentage of money damages recovered: 20 percent of the first \$25,000 and 10 percent of any additional sums recovered at trial.⁷⁰ 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.⁷¹ Loser-pays systems in most foreign countries award much higher percentages of legal fees incurred, although those fees are subject to some judicial discretion.

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. This number was only slightly below the national median of 6,610 per 100,000 that year and was very close to the filing rates of other relatively rural states.⁷²

The composition of civil filings, though, differs somewhat from the national pattern.⁷³ As Figure 7 shows, domestic relations and probate matters, which are not governed by loser pays, form a much larger share of total civil litigation in Alaska than in the United States generally. By the same token, Alaska’s tort claims constitute a smaller share of Alaska’s litigation mix than they do elsewhere.

These statistics suggest, but certainly do not prove, that loser pays is responsible for more selective filing of tort claims in Alaska than in other jurisdictions.

Figure 7



Di Pietro, Alaska’s English Rule: Attorney’s Fee Shifting in Civil Cases, pp. 83–84. Percentages may not add up to 100 due to rounding. Small claims are excluded in order to permit a more representative comparison.

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 most of them are filed by litigants for “emotional,” rather than financial, reasons.⁷⁴ They also observed that many frivolous litigants are judgment-proof (i.e., without sufficient means to pay shifted fees).⁷⁵ But the Council’s survey question, in asking about “frivolous” suits, was misleading, since “frivolousness” is a legal term of art denoting truly flagrant cases, 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.⁷⁶ The Council’s finding was merely qualitative, not quantitative, but nevertheless important, especially since defendants are able to recover only 20 to 30 percent 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 than in the rest of the country.⁷⁷ 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 uniqueness. The state has enormous natural resources reserves, a large indigenous population, and substantially more men than women. 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.⁷⁸ 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.

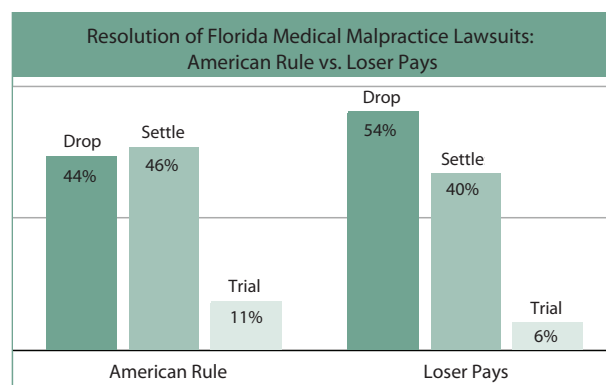
The Florida Experiment

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.⁷⁹ 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.⁸⁰ However, both groups quickly discovered a problem with the new system—the frequent inability of victorious defendants actually to collect their attorneys' fees from insolvent plaintiffs⁸¹—and they were taken aback by the multimillion-dollar plaintiff's attorneys' fee that a Florida doctor who had lost the case against him was ordered to pay.⁸² With every interest group lobbying for its repeal, Florida's loser-pays law was wiped from the books in 1985.⁸³

The first rigorous analysis of the Florida law's effects was published five years later, and its findings sug-

gest that the loser-pays experiment was given short shrift by policymakers and its erstwhile advocates. Economists Edward A. Snyder and James W. Hughes found that 54 percent of medical-malpractice plaintiffs voluntarily dropped their lawsuits under Florida's loser-pays rule, while only 44 percent of plaintiffs dropped their suits when the American rule was in force both before and after the loser-pays rule was in effect. Loser pays also almost halved the share of medical-malpractice lawsuits that went to trial—from 11 percent to 6 percent (see Figure 8).

Figure 8



Snyder, E. A., & Hughes, J. W. (1990). *The English Rule for Allocating Legal Costs: Evidence Confronts Theory*. *Journal of Law, Economics, & Organization*, 6 (2), 345-380, pp. 363-64. 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).⁸⁴ Most notably, settlements of less than \$10,000 dropped from 49 percent of all settled cases under the American rule to less than 37 percent under loser pays,⁸⁵ 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 \$25,190 to \$69,390 in constant dollars,⁸⁶ and plaintiffs more often prevailed at trial. 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."⁸⁷

Florida cases did experience an increase in litigation expenses, both those that settled and those that proceeded to trial during the loser-pays experiment.⁸⁸ However, costs relative to the size of the verdict changed very little, and it would be worth exploring whether the explanation is that defendants were simply spending more on individual cases 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 should be far more likely to abandon their claims under loser pays, which allows lawyers 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. Attorneys' fees per case did rise during this period, 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 favored losing plaintiffs with few assets, who couldn't afford to pay the winning defendants' attorneys' fees.⁸⁹ But, Hughes and Snyder surmise, loser pays actually encouraged plaintiffs with assets to settle or drop weak cases early in order to avoid having to pay a fee award.⁹⁰ 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 do not stop the rule from functioning.

PART V: PRESERVING ACCESS THROUGH INSURANCE

A loser-pays rule should reduce the volume of nuisance litigation and more fully compensate plaintiffs with strong cases. These gains would come at a heavy 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 insurance, all of which indemnify participating plaintiffs for attorneys' fees in the event of a courtroom loss. Because the level of union membership is lower in the United States than elsewhere and because publicly funded legal aid has been historically unpopular here, 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 only of suits initiated by the covered party, assuming that the insurance company deems the suit in question to have a solid basis.

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. 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. In some jurisdictions, the ATE premiums that a winning plaintiff has paid can be recovered from a losing defendant.⁹¹

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. Such concerns would be overblown. Plaintiffs’ lawyers already screen potential cases as to merit and decline to handle the majority of prospective claims that they are offered. In a competitive insurance market, plaintiffs’ lawyers could shop their cases among insurers. And nothing in theory would prevent a plaintiff’s lawyer himself 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.⁹² If a claim were denied both ATE coverage and self-insurance by a plaintiff’s attorney, it would be because it was highly unlikely to succeed,⁹³ 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 percent of all households have policies.⁹⁴ 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.⁹⁵

The cost of LEI is generally modest.⁹⁶ 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. If American jurisdictions adopted loser pays, traditional LEI policies would have a market among middle-income Americans who have assets to protect and commonly 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. England and Wales historically disallowed fee arrangements that depended on the outcome of a lawsuit. In 1990, however, Parliament passed a measure legalizing “conditional fee agreements” (CFAs) for personal-injury claims and certain other proceedings.⁹⁷ 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.⁹⁸ In 1998, the government extended the measure to allow CFA agreements in all civil cases except those involving family law.⁹⁹

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.¹⁰⁰ The former eligibility of a majority may have had the effect of 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 at least six insurance companies, which advertise ATE policies online;¹⁰¹ at least two post applications, as well, online.¹⁰² They are four to six pages in length and are filled out by plaintiffs’ attorneys. The fee is generally £100–200, which can be advanced by the applicant’s lawyer. If the plaintiff prevails, he

can also recover from the defendant the premiums he has paid; at least some advertised ATE policies do not charge the premium until a verdict has been rendered and unless it is in the plaintiff's favor.

In 2003, ATE constituted about 29 percent of the larger LEI market in Britain and collected some £110 million in premiums.¹⁰³ A British trade publication recently estimated that ATE insurance is now purchased for three in four civil lawsuits filed under conditional fee agreements.¹⁰⁴ 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.

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 percent 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 their lawyers to advance the premium, as they do other litigation costs, in order to preserve access to the courts.

Finally, loser-pays reforms should be designed to minimize any increases in costs per case and any negative effect on the prospects of settlement. In order to accomplish this, loser pays should be accompanied by a modified offer-of-judgment rule (similar to those already present in many state systems and in federal

courts) 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 are extended to include attorneys' fees, they should encourage timely settlement of claims.

PART VII: A PROPOSAL FOR REFORM

The Manhattan Institute 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.

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 percent 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.¹⁰⁵

The following goals of a loser-pays reform are addressed by this proposal:

Compensating Winning Litigants

Like other loser-pays rules, this proposal better compensates litigants who prevail at trial by reimbursing them for at least a portion of the considerable cost of litigation. Litigation expenses of prevailing parties will be reimbursed up to 30 percent of the difference between the relevant settlement offer of the losing party and the amount recovered at trial.

Reducing the Number of Abusive Lawsuits

By reducing the expected cost to defendants of fighting abusive suits, this proposal should weaken the ability of the plaintiffs and their lawyers who file them to induce defendants to settle. This proposal should also reduce the volume of abusive lawsuits by requiring plaintiffs to demonstrate that they have the means to pay the defendant's attorneys' fees if they do not prevail. This requirement would frequently be met by litigation insurance, which would be made available only to plaintiffs with reasonably strong cases.

Promoting Early Settlement

This proposal should promote early settlement in at least two ways. First, it should encourage the parties to make settlement offers at an early stage of litigation, before expenses have mounted. Second, it

should encourage the parties 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.

Containing Litigation Costs

Our proposal should limit the incentives to spend more on litigation that a different kind of loser-pays rule might create. Ours does so by capping recoverable fees at 30 percent of the difference between the amount of the judgment at trial and the amount of the non-prevailing parties' relevant settlement offer. Additional litigation expenses will be borne entirely by the party that chose to incur them.

Promoting Litigation Insurance

As with any loser-pays rule, a healthy litigation insurance market would be a crucial part of ensuring access to justice for plaintiffs with meritorious cases. Such access also benefits society by promoting compliance with legal standards of care. To promote the development of a litigation insurance market, our proposal 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 and other common-law jurisdictions.

Conclusion

The United States pays a high price for a system of justice that uniquely encourages abusive litigation, but it need not continue to do so. Thoughtful reforms in state and federal law can bring our civil justice system into sync with the rest of the world by replacing the American rule for attorneys' fees with a loser-pays system. Loser pays need not close 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 that reasonable limits to the parties' exposure to liability for fees, if they are incorporated into an offer-of-judgment mechanism, can promote early settlement.

FORMAL MODEL OF LOSER-PAYS PROPOSAL

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 $P(j)$ represents the probability that the net total judgment for the plaintiff at trial will be less than j . Let J represent the expected value of the judgment if the lawsuit goes to trial: $J = \int j dP(j)$. Let C_n 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) $C_n > .3(J_{\Omega \leq j} - \Omega)$; AND 3) $C_\Delta > .3(\Phi - J_{j < \Omega})$.

The plaintiff's expected gain at trial is:

$$U_n \equiv J - [C_n - .3(J_{\Omega \leq j} - \Omega)] - P(\Omega)[C_n + .3(\Phi - J_{j < \Omega})]$$

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_n is decreasing in Φ , which should encourage the plaintiff to make a modest settlement offer. U_n is also decreasing in C_n , meaning that the plaintiff has an incentive to control its litigation costs. Because it is strictly true that $C_n \geq [C_n - .3(J_{\Omega \leq j} - \Omega)]$, this proposal appears to reduce the incentive that the plaintiff has to control its costs. However, in cases in which $[C_n - .3(J_{\Omega \leq j} - \Omega)] \geq 0$ (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_n increases in J and decreases in $P(\Omega)$, 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 $[C_\Delta - .3(\Phi - J_{j < \Omega})] \geq 0$.

Note: This model is adapted from a model suggested by Tai-Yeong Chung, "Settlement of Litigation under Rule 68: An Economic Analysis," *Journal of Legal Studies* 25, no. 1 (1996): 261–86. To keep the math as simple as possible, all actors are assumed to be risk-neutral wealth maximizers in this model, but the directional effects are the same if just one or both parties are assumed to be risk-averse.

1. Towers Perrin Tillinghast, *2007 Update on U.S. Tort Cost Trends* (Valhalla, NY: Towers Perrin, 2007), p. 3.
2. Towers Perrin Tillinghast, *U.S. Tort Costs and Cross-Border Perspectives: 2005 Update* (Valhalla, NY: Towers Perrin, 2005), p. 4.
3. *Ibid.*, p. 4.
4. Towers Perrin Tillinghast, *2007 Update on U.S. Tort Cost Trends*, p. 5.
5. Marc Fisher, "Judge Who Seeks Millions for Lost Pants Has His (Emotional) Day in Court," *Washington Post*, June 13, 2007, B01. Studies have indicated that 65–85 percent of jury-eligible people in the United States believe that there are too many frivolous lawsuits filed. Richard Waites and Joan Kellerman, *Juror Perceptions About Lawsuits and Tort Reform*, The Advocates (New York: The Advocates, 2008), p. 1.
6. Henri E. Cauvin, "Court Rules for Cleaners in \$54 Million Pants Suit," *Washington Post*, June 26, 2007, A01.
7. *Ibid.*
8. Marc Fisher, "Dry Cleaners' Victory in Pants Lawsuit Still Comes With a Loss," *Washington Post*, September 20, 2007, B01.
9. *Ibid.*
10. *Ibid.*
11. "\$54 Million 'Pants' Lawsuit Headed Back to Court," ABC News 7, September 10, 2008, <http://www.wjla.com/news/stories/0908/552285.html>.
12. The term "frivolous," unlike these other descriptors, has a legal meaning; it refers to the standard under which a court may sanction litigants under FRCP 11 and its state law counterparts. 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.
13. Klemm Analysis Group, *Impact of Litigation on Small Business* (Washington, D.C.: U.S. Small Business Association, 2005), p. 15.
14. Fisher, "Dry Cleaners' Victory."
15. Klemm Analysis Group, *Impact of Litigation on Small Business*, p. iv.
16. *Ibid.*, p. 8. For the purpose of this statistic, the report defines "small business" as any business with fifty or fewer employees.
17. *Ibid.*, p. 12.
18. *Ibid.*, p. 2.
19. *Ibid.*, p. ii.
20. *Ibid.*, p. iii.
21. 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?," *Arizona Journal of International and Comparative Law* 16 (1999): 361–436.
22. "The Trouble with Lawyers," ABC television broadcast, January 2, 1996.
23. See, generally, Deborah L. Rhode, "Too Much Law, Too Little Justice: Too Much Rhetoric, Too Little Reform," *Georgetown Journal of Legal Ethics* 11 (1997–98): 989–1018.
24. John F. Vargo, "The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice," *American University Law Review* 42 (1993): 1567–1636, at 1609.
25. See, generally Rhode, "Too Much Law."
26. Herbert M. Kritzer, *Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States* (Stanford, Calif.: Stanford University Press, 2004), p. 2.
27. *Ibid.*, p. 98.
28. Kritzer argued recently in an online forum that most such suits in his data set featured weak evidence of causation rather than weak evidence of a breach of a duty of care. See New Talk discussion "Would Loser Pays Eliminate Frivolous Lawsuits and Defenses?," available at <http://newtalk.org/2008/08/would-loser-pays-eliminate-fri.php>. 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.
29. Eyal Zamir and Ilana Ritov, "Neither Saints Nor Devils: A Behavioral Analysis of Attorneys' Contingent Fees," Social Science Research Network (January 22, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1085985.
30. Lester Brickman, "The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?," *Cardozo Law Review* 25, no. 1 (2003): 65–128. See also Kritzer, *Risks, Reputations, and Rewards*, pp. 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.
31. Zamir and Ritov, "Neither Saints Nor Devils."
32. Kritzer, *Risks, Reputations, and Rewards*, p. 76.
33. *Ibid.*
34. *Ibid.*, p. 15.
35. Richard A. Nagareda, *Mass Torts in a World of Settlement* (Chicago: University of Chicago Press, 2007), pp. 9–10.
36. David Rosenberg and Steven Shavell, "A Model in Which Suits Are Brought for Their Nuisance Value," *International Review of Law and Economics* 5 (1985): 3–13.
37. Lucian Arye Bebchuk, "Litigation and Settlement Under Imperfect Information," *RAND Journal of Economics* 15, no. 3 (1984): 404–15.

38. See Model Rules of Professional Conduct §1.16.
39. Indeed, 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. Kritzer, *Risks, Reputations, and Rewards*, tables 6.2a and 6.2b.
40. Lucian Arye Bebchuk and Andrew T. Guzman, "How Would You Like to Pay for That? The Strategic Effects of Fee Arrangements on Settlement Terms," *Harvard Negotiation Law Review* 1 (spring 1996): 53–63.
41. Kritzer, *Risks, Reputations, and Rewards*, p. 177.
42. *Ibid.*; see also David M. Trubek et al., "The Costs of Ordinary Litigation," *UCLA Law Review* 31 (1983–84): 72–127, at 89; and Kevin McCabe and Laura Inglis, *Using Neuroeconomics Experiments to Study Tort Reform*, Policy Comment (Arlington, Va.: Mercatus Center at George Mason University, 2007), p. 12.
43. 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," *The Journal of Legal Studies* 11 (January 1982): 55–81, at 59. See also Lucian Arye Bebchuk, "A New Theory Concerning the Credibility and Success of Threats to Sue," *The Journal of Legal Studies* 25 (January 1996): 1–25; Avery Katz, "Measuring the Demand for Litigation," *The Journal of Law, Economics, & Organization* 3, no. 2 (1987): 143–76; Gordon Tullock, *Trials on Trial: The Pure Theory of Legal Procedure* (New York: Columbia University Press, 1980); and McCabe and Inglis, *Using Neuroeconomics Experiments to Study Tort Reform*. But cf. Ronald Braeutigam, Bruce Owen, and John Panzar, "An Economic Analysis of Alternative Fee Shifting Systems," *Law and Contemporary Problems* 47, no. 1 (winter 1984): 173–85 (results ambiguous).
44. 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.
45. Bebchuk, "A New Theory Concerning the Credibility and Success of Threats to Sue"; Keith N. Hylton, "Litigation Cost Allocation Rules and Compliance with the Negligence Standard," *The Journal of Legal Studies* 22, no. 2 (1993): 457–76; Katz, "Measuring the Demand for Litigation"; Shavell, "Suit, Settlement, and Trial"; and Tullock, *Trials on Trial*. But cf. Edward A. Snyder and James W. Hughes, "The English Rule for Allocating Legal Costs: Evidence Confronts Theory," *The Journal of Law, Economics, & Organization* 6, no. 2 (fall 1990): 345–80.
46. 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.
47. Kritzer, *Risks, Reputations, and Rewards*, table 3.9.
48. 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.
49. Potential class actions are, of course, an exception to this rule.
50. Studies suggesting that a loser-pays rule would raise settlement rates include: Michael R. Baye, "Comparative Analysis of Litigation Systems: An Auction-Theoretic Approach," *Economic Journal* 115 (2005): 583–601; and Snyder and Hughes, "The English Rule for Allocating Legal Costs." Studies suggesting that a loser-pays rule would lower settlement rates include: Lucian Arye Bebchuk and Howard F. Chang, "An Analysis of Fee Shifting Based on the Margin of Victory: On Frivolous Suits, Meritorious Suits, and the Role of Rule 11," *The Journal of Legal Studies* 25, no. 2 (June 1996): 371–403; Keith N. Hylton, "An Asymmetric Model of Litigation," *International Review of Law and Economics* 22 (May 2002): 153–75; McCabe and Inglis, *Using Neuroeconomics Experiments to Study Tort Reform*; and Shavell, "Suit, Settlement, and Trial."
51. See, for example, Hylton, "Litigation Cost Allocation Rules and Compliance with the Negligence Standard," p. 459.
52. Shavell, "Suit, Settlement, and Trial," p. 68.
53. McCabe and Inglis, *Using Neuroeconomics Experiments to Study Tort Reform*, p. 18.
54. Don Coursey and Linda Stanley, "Pretrial Bargaining Behavior in the Shadow of the Law: Theory and Experimental Evidence," *International Review of Law and Economics* 8, no. 2 (1988): 175–76. See also Peter Coughlan and Charles Plott, "An Experimental Analysis of the Structure of Legal Fees: American Rule vs. English Rule," Social Science Working Paper No. 1025, Division of the Humanities and Social Sciences, California Institute of Technology (1997), p. 35.
55. Trubek et al., "The Costs of Ordinary Litigation," p. 89. See also Kritzer, *Risks, Reputations, and Rewards*, p. 177.
56. See Baye, "Comparative Analysis of Litigation Systems"; Katz, "Measuring the Demand for Litigation"; and Braeutigam, Owen, and Panzar, "An Economic Analysis of Alternative Fee Shifting Systems."
57. Katz, "Measuring the Demand for Litigation," p. 160.
58. *Ibid.*, n. 28.
59. *Ibid.* ("[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" (*ibid.*, p. 172).

60. Trubek et al., table 8.
61. Kritzer, *Risks, Reputations, and Rewards*, p. 17.
62. *Ibid.*, pp. 17–18, 138.
63. Trubek et al., table 8 (indicating that “events” such as motions and discovery requests are the primary driver of costs in the typical case).
64. At least arguably, some laws in existence may be so misguided that compliance with them reduces, rather than increases, social welfare. As noted in Part I of the report, this paper assumes that the substantive contract and tort law that would primarily be affected by loser pays is sufficiently aligned with the social interest that compliance with this body of law, in the aggregate, is welfare-enhancing.
65. Keith N. Hylton, “An Asymmetric Model of Litigation,” *International Review of Law and Economics* 22 (May 2002): 153–75. For his earlier version of the tort liability model, which did not yield as strong a compliance effect because it failed to capture the effects of fee shifting on settlement offers, see Keith N. Hylton, “Litigation Cost Allocation Rules and Compliance with the Negligence Standard,” *The Journal of Legal Studies* 22, no. 2 (1993): 457–76.
66. Hylton, “An Asymmetric Model of Litigation,” p. 162.
67. *Ibid.*, p. 168.
68. Towers Perrin Tillinghast, *U.S. Tort Costs and Cross-Border Perspectives: 2005 Update*, Report (Valhalla, NY: Towers Perrin, 2005), p. 5.
69. See, generally, Richard A. Posner, *Law and Legal Theory in England and America* (Oxford: Clarendon Press, 1996).
70. Alaska Civil Rule 82(b)(1). Lesser percentages are recoverable in cases that are settled or are uncontested.
71. Alaska Civil Rule 82(b)(2). Plaintiffs who sue for nonmonetary damages may recover under this provision as well.
72. Di Pietro, S., Carns, T. W., & Kelley, P. (1995). *Alaska’s English Rule: Attorney’s Fee Shifting in Civil Cases*. Anchorage, Alaska: Alaska Judicial Council.
73. *Ibid.*, p. 84.
74. *Ibid.*
75. *Ibid.*, p. 132.
76. *Ibid.*, p. 138.
77. *Ibid.*, p. 104.
78. Michael J. Goldberg, “The Propensity to Sue and the Duty of Fair Representation: A Second Point of View,” *Industrial and Labor Relations Review* 41, no. 3 (April 1988): 456–61, at 457.
79. Fla. Stat. Ann. § 768.56 (West 1984), repealed by 1985 Fla. Laws ch. 85-175, § 43 (repeal effective October 1, 1985).
80. See *Miami Herald*, September 28, 1982, p. A11.
81. Staff Analysis of HB 1352, Committee on Health Care and Insurance, Florida House of Representatives, Doc. No. PCB85-02/BS, June 4, 1985.
82. B. Richard Young, “Comment: Medical Malpractice in Florida: Prescription for Change,” *Florida State University Law Review* 10 (winter 1983): 593–618, at 608.
83. 1985 Fla. Laws ch. 85-175, §43 (repeal effective October 1, 1985).
84. James W. Hughes and Edward A. Snyder, “Litigation and Settlement Under the British and American Rules: Theory and Evidence,” *Journal of Law and Economics* 38, no. 1 (April 1995): 225–50, table 7.
85. *Ibid.*
86. *Ibid.*, table 5.
87. *Ibid.*, p. 226.
88. Snyder, E. A., & Hughes, J. W. (1990). The English Rule for Allocating Legal Costs: Evidence Confronts Theory. *Journal of Law, Economics, & Organization*, 6 (2), 345-380, Table 6.
89. Florida law formally exempted litigants from liability for their opponents’ attorneys’ fees if they were unable to pay them. Fla. Stat. Ann. § 768.56 (West 1984) (stating that “attorney’s fees shall not be awarded against a party who is insolvent or poverty-stricken”), repealed by 1985 Fla. Laws ch. 85-175, § 43 (repeal effective October 1, 1985). See Snyder and Hughes; *supra* n. 88.
90. Snyder and Hughes, The English Rule for Allocating Legal Costs: Evidence Confronts Theory 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. Di Pietro, *Alaska’s English Rule: Attorney’s Fee Shifting in Civil Cases*, p. 102.
91. John Peysner, “A Revolution by Degrees: From Costs to Financing and the End of the Indemnity Principle,” *Web Journal of Current Legal Issues* 1 (February 2001), available at <http://webjcli.ncl.ac.uk/2001/issue1/peysner1.html>.
92. 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.
93. 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.

94. Matthias Kilian, "Alternatives to Public Provision: The Role of Legal Expenses Insurance in Broadening Access to Justice: The German Experience," *Journal of Law and Society* 30, no. 1 (2003): 31–48, at 38.
95. *Ibid.*, p. 39.
96. 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." *Modernising Justice*, Report of the Lord High Chancellor, Lord Chancellor's Department (London: Martin Pearce Associates, 1998), §2.35.
97. Adrian Walters and John Peysner, "Event-Triggered Financing of Civil Claims: Lawyers, Insurers and the Common Law," *Nottingham Law Journal* 8, no. 1 (1999): 8.
98. *Modernising Justice*, §2.42.
99. *Ibid.*, §2.43.
100. See, generally, Neil Rickman, Paul Fenn, and Alastair Gray, "The Reform of Legal Aid in England and Wales," *Fiscal Studies* 20, no. 3 (1999): 261–86.
101. See 1st Class Legal at www.ateinsurance.com; Accident Line at www.accidentlinedirect.co.uk/funding.php; FirstAssist at www.firstassist.co.uk/legal/legal_products/pursuit.asp; HSBC Insurance at www.insurancebrokers.hsbc.com/hsbc/legal_protection; LawAssist at www.lawassist.co.uk; Legal Ex at www.legalexplus.com/legal-expenses-terms.asp; Stirling Legal Services at www.stirlinglegal.com/litigation_insurance.php; and The Judge at www.thejudge.co.uk/after-event-insurance.asp.
102. See, for example, 1st Class Legal at www.ateinsurance.com; and The Judge at www.thejudge.co.uk/after-event-insurance.asp.
103. OFT report, "The UK Liability Insurance Market: A Follow-Up to the OFT's 2003 Market Study" (2005), §5.8, available at www.oft.gov.uk/shared_oftrreports/financial_products/oft802.pdf.
104. Katy Dowell, "False Economy," in *The Lawyer.com*, February 18, 2008, available at <http://www.thelawyer.com/cgi-bin/item.cgi?id=131305&d=415&h=417&f=416>.
105. 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*, 6th ed. (St. Paul, Minn.: West Publishing), p. 231.

DIRECTOR

James R. Copland

FELLOWS

Marie Gryphon

Peter W. Huber

Walter K. Olson

The Center for Legal Policy (CLP) works to advance the principled, long-term reform of our nation's civil justice system by offering incisive, rigorous, and sound analysis of the system's problems as well as effective practical solutions. For over twenty years, CLP has provided the intellectual underpinnings for various reform efforts.

CLP houses two of the "founding fathers" of civil justice reform—senior fellows Walter K. Olson and Peter W. Huber. Huber's book, *Liability*, and Olson's, *The Litigation Explosion*, helped spark the civil justice reform movement. Huber's books on junk science, *Galileo's Revenge* and *Judging Science*, as well as his many other writings on this topic, have given shape to significant improvements in the court's handling of scientific evidence. Olson's book on employment law, *The Excuse Factory*, illuminated a dangerous trend in litigation, and his newest book, *The Rule of Lawyers*, explores regulation by litigation and its threat to democracy. Huber and Olson appear regularly in high-end media outlets, such as the editorial pages of leading newspapers and major national talk shows.

Jim Copland is the director of the Center for Legal Policy. Copland specializes in litigation reform, medical malpractice, and securities litigation. He has been widely published in national, local, and online newspapers and frequently appears on various television and radio shows. Copland is also project director for Trial Lawyers, Inc., a series of reports that shed light on the size, scope, and inner workings of the litigation industry. The annual report-style publication, TrialLawyersInc.com website, and ongoing forums and updates offer must-have information on American civil justice.

Senior fellow Marie Gryphon has been an attorney in private practice where she worked on ERISA, securities, class action, commercial contract, legal malpractice, and constitutional law cases. Gryphon is an expert on loser pays, litigation reforms, and law and economics. Her articles have appeared in *The Washington Post*, *Forbes*, and National Review Online.

CLP's web magazine, PointofLaw.com, brings together information and opinion on the U.S. litigation system. Edited by Olson and Jim Copland, PointofLaw.com features up-to-the-minute blogging and regular in-depth columns and discussions from leading academics and practitioners, as well as an archive of books and downloadable articles central to understanding the debate over legal reform. Olson also edits the website Overlawyered.com, a resource-rich information hub that allows legal-reform advocates, reporters, and policymakers to track issues and stay on top of significant developments in the litigation world.

Through the commissioning and publication of books, papers, and transcripts, and the convening of conferences and other discussion forums, the Center for Legal Policy aims to communicate thoughtful ideas on civil justice reform to real decision-makers