

THE DIFFICULTIES OF ENCOURAGING COOPERATION IN A ZERO-SUM GAME

Jacob Kreutzer

ABSTRACT

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ABSTRACT

The Federal Rules of Civil Procedure generally provide only the “rules of the road” on which litigation is conducted. However, in some areas the Rules step outside of this role and attempt to overtly encourage cooperation. One such rule is Rule 68, which allows a defendant to make an offer of judgment to the plaintiff, and provides that if the plaintiff refuses and subsequently wins less money than the defendant offered, the plaintiff must cover the defendant’s costs. Rule 68 was launched into prominence when the Supreme Court ruled, in *Marek v. Chesney*, that a Rule 68 offer could negate the operation of attorney’s fee-shifting statutes. A storm of proposals, counter-proposals, analyses and critiques of the Rule soon followed. This article compares Rule 68 to Rule 4(d), which has been operating quietly for some time to encourage parties to cooperate to avoid the costs of service of process. The comparison serves to highlight some of the unappreciated features of Rule 68 as it currently stands, and some of the potential pitfalls to the commonly proposed expansion of the rule. The article concludes by offering a reform proposal designed to enhance the likelihood of reasonable settlements while avoiding the normative and practical problems inherent in expanding Rule 68.

INTRODUCTION

The Federal Rules of Civil Procedure represent a monumental effort to channel aggression and resolve conflicts. An idealistic person might describe them as reflecting our society’s highest ideals of fairness and principled decision making in the face of disagreement. A more cynical person might describe them as the rules to the game of litigation that lawyers play professionally.

Whether we view the rules as setting the terms of a game or setting up a framework for rendering decisions, the rules encouraging cooperation between the parties seem an odd fit. Most games do not feature such rules—the National Football League does not encourage teams to stipulate to the results of the Super Bowl—and attempting to foster cooperation between parties who are locked in zero-sum competition is fraught with peril.

This article focuses on two such rules in particular: Rule 4(d) and Rule 68. Rule 4(d) encourages a defendant who has been given actual notice of a suit to waive the need for formal service of process by imposing the cost of service on defendants who decline.¹ Rule 68 promotes settlement by penalizing a plaintiff who refuses an offer and subsequently recovers less than the offered amount,² and

* Visiting Assistant Professor, The Dickinson School of Law of the Pennsylvania State University. I am very grateful to Erica Goldberg, David Kaye, Nancy Welsh, and Adam Muchmore for their comments on earlier drafts of this article.

1. Fed. R. Civ. P. 4(d)(2).

2. Fed. R. Civ. P. 68(d).

has been the subject of considerable scholarly examination.³ Many different reforms of Rule 68 have been proposed,⁴ and states continue to experiment with Rule 68-like additions to their own codes of civil procedure.⁵

This article concludes that Rule 68, as currently interpreted, works surprisingly well. It operates to prevent plaintiffs from leveraging fee-shifting statutes to obtain settlement offers in excess of what they could hope to win at trial, and the limitations on its application prevent it from wreaking much injustice. However, broadening Rule 68's reach to influence all civil litigation will bring within its scope many cases where the parties are uncertain of the results of going to trial, in which case it is unfair and counterproductive to penalize them for failing to settle.

The framework imposed by Rule 68 defines as unreasonable the rejection of an offer that exceeds the ultimate judgment obtained.⁶ Such a definition makes practical and moral sense only if both plaintiff and defendant are certain of the outcome of the case at the time that the offer is made. The only context where we would logically expect defendants to extend (and plaintiffs to reject) such an offer is in a case where the defendant must pay plaintiff's attorney's fees if defendant loses. In such cases, refusing to impose fees incurred after the rejection of an offer

3. See Geoffrey P. Miller, *An Economic Analysis of Rule 68*, 15 J. LEGAL STUD. 93 (1986); George L. Priest, *Regulating the Content and Volume of Litigation: An Economic Analysis*, 1 SUP. CT. ECON. REV. 163 (1982); Thomas D. Rowe, Jr., *Predicting the Effects of Attorney Fee-Shifting*, 47 LAW & CONTEMP. PROBS. 139 (1984); Tai-Yeong Chung, *Settlement of Litigation Under Rule 68: An Economic Analysis*, 25 J. LEGAL STUD. 261 (1996); Lucian Arye Bebchuk & Howard F. Chang, *The Effect of Offer-of-Settlement Rules on the Terms of Settlement*, 28 J. LEGAL STUD. 489 (1999).

4. In 1983, the committee proposed expanding the rule to cover attorney's fees, and to allow both sides to make offers that could trigger the fee-shifting provision. See *Preliminary Draft of Proposed Amendments to the Federal Rules of Civil Procedure*, 98 F.R.D. 339, 361-63 (1983) [hereinafter *1983 Proposal*]. In 1984, the committee proposed a rule that would change the fee-shifting trigger to a determination by the judge that the offer was rejected unreasonably, rather than a simple comparison of the offer to the final judgment. See *Preliminary Draft of Proposed Amendments to the Federal Rules of Civil Procedure*, 102 F.R.D. 425, 433-34 (1984) [hereinafter *1984 Proposal*]. Many other changes have been proposed. See Jay N. Varon, *Promoting Settlements and Limiting Litigation Costs by Means of the Offer of Judgment: Some Suggestions for Using and Revising Rule 68*, 33 AM. U. L. REV. 813, 845-47 (1984); Roy D. Simon, Jr., *The Riddle of Rule 68*, 54 GEO. WASH. L. REV. 1, 53-75 (1985); John E. Sprizzo, *Unjustifiable Refusals to Settle and Rule 68*, 62 ST. JOHN'S L. REV. 443, 451-52 (1988); William W. Schwarzer, *Fee-Shifting Offers of Judgment—An Approach to Reducing the Cost of Litigation*, 76 JUDICATURE 147 (1992); David A. Anderson, *Improving Settlement Devices: Rule 68 and Beyond*, 23 J. LEGAL STUD. 225, 240-44 (1994); *ABA Urges Offer of Judgment Changes to Counter Movement to 'Loser Pays' Rule*, 64 U.S.L.W. 2495 (1996) (discussing a reform proposal put forth by the ABA); Keith N. Hylton, *Rule 68, the Modified British Rule, and Civil Litigation Reform*, 1 MICH. L. & POL'Y REV. 73, 97-98 (1996); Joshua P. Davis, *Toward a Jurisprudence of Trial and Settlement: Allocating Attorney's Fees by Amending Federal Rule of Civil Procedure 68*, 48 ALA. L. REV. 65 (1996); Michael E. Solimine & Bryan Pacheco, *State Court Regulation of Offers of Judgment and its Lessons for Federal Practice*, 13 OHIO ST. J. ON DISP. RESOL. 51, 76-77 (1997); Lesley S. Bonney et al., *Rule 68: Awakening a Sleeping giant*, 65 GEO. WASH. L. REV. 379, 427-28 (1997). Others have proposed doing away with the rule altogether. See Robert G. Bone, "To Encourage Settlement": *Rule 68, Offers of Judgment, and the History of the Federal Rules of Civil Procedure*, 102 NW. U. L. REV. 1561, 1618 & n. 246; Bruce P. Merenstein, *More Proposals to Amend Rule 68: Time to Sink the Ship Once and For All*, 184 F.R.D. 145, 148 (1999).

5. See William P. Lynch, *Rule 68 Offers of Judgment: Lessons from the New Mexico Experience*, 39 N.M. L. REV. 349, 354-55 (2009); Solimine & Pacheco, *supra* note 4, at 63-65; Albert Yoon, *Symposium on FRCP 68: Lessons from New Jersey*, 57 MERCER L. REV. 825, 826-829 (2006).

6. Fed. R. Civ. P. 68(d).

can act as a valuable check on strategic behavior by the plaintiff. In other cases, where attorney's fees will be borne by the parties that incur them, it is much more likely that a refusal to settle indicates disagreement over the ultimate result of the case, or strategic behavior by a defendant who is making an offer simply to invoke the fee-shifting rule. Adopting any of the proposed expansions of Rule 68 in an attempt to increase settlements will tend to create an unjust, unworkable rule.

Both Rule 4(d) and Rule 68 attempt to encourage the parties to cooperate in order to avoid paying fees to a third party. Rule 4(d) encourages the parties to avoid paying a process server, while Rule 68 encourages them to settle and avoid paying attorney's fees and court costs. Rule 4(d) is able to create a clear (if relatively weak) incentive by taking the normative position that defendants who have been given notice of a suit should waive their right to formal service of process. In contrast, Rule 68 quite reasonably fails to take the stance that all plaintiffs presented with settlement offers must settle; instead, it attempts to discourage *unreasonable* refusals to settle. The problem with this, as this article will explore, is that it is impossible to construct a mathematical formula to determine what offers are reasonable.⁷ In addition, Rule 4(d) has the advantage of encouraging cooperation on an issue that is ancillary to the main body of the case. The parties can agree not to require service of process without affecting their overall contest. In contrast, Rule 68 attempts to encourage the parties to settle their entire dispute. The reason that a broad application of Rule 68 is problematic is that even if the parties are collectively better off settling than not settling, the settlement negotiations themselves remain a zero-sum game, where each party can improve its position only at the expense of the other.

A comparison between Rule 4(d) and Rule 68 is instructive because Rule 4(d) works in a reasonably straightforward fashion to encourage cooperation. In the situations where Rule 68 tends to work well, it shares this virtue. In most of the areas in which the implications of the fee-shifting rule are more complex, applying Rule 68 becomes more problematic. The differences between Rule 4(d) and Rule 68 also highlight the areas in which an expanded Rule 68 would undermine its own goals.

Rule 68, as currently implemented, provides a valuable escape hatch that allows defendants in fee-shifting cases to surrender, and avoid having additional attorney's fees heaped upon them. However, the structure of Rule 68 is not well suited to encourage settlements in many cases, and attempting to expand its impact beyond its current area of operation may have some distributional impact on litigants, but is unlikely to reduce trials. In addition, similar lines of analysis suggest that if we want to put pressure on the parties to settle without creating opportunities for gamesmanship, adopting an evaluative mediation process would be more helpful than trying to create complicated rules that will compel the parties to disclose their settlement value. Part I of this article will provide background on the history and current state of Rule 4 and Rule 68. Part II will break down Rule 4 and discuss how it creates positive incentives while avoiding gamesmanship by the parties. Part III will discuss the current operation and interpretation of Rule 68 and provide a novel defense of the status quo. Part IV will discuss proposed revisions

7. See Sprizzo, *supra* note 4, at 447-48.

of Rule 68 and the practical problems inherent in any attempt to encourage cooperation in litigation by extending application of the Rule. Part V will briefly discuss a suggested reform to encourage settlement without creating opportunities for gamesmanship by the parties.

I. BACKGROUND: RULE 4 AND RULE 68

Rule 4(d) of the Federal Rules of Civil Procedure is intended to promote waiver of service of process, and does so in a straightforward fashion. Although Rule 68 is often described as having been designed to encourage settlement,⁸ it does so in an indirect fashion that often does not hold up under scrutiny. Later sections will discuss the practical problems inherent to Rule 68's design; this section is intended only to provide an understanding of the operation of both rules.

Rule 4 underwent significant revision when the Federal Rules were amended on December 1, 1993.⁹ One major change was the inclusion in Rule 4(d) of a process for requesting a waiver of summons.¹⁰ It provides that a plaintiff may notify a defendant that an action has been commenced and request that the defendant waive the service of a summons.¹¹ If the defendant grants the waiver, the defendant is given 60 days to answer the complaint, rather than the 21 days given after formal service of process.¹² Should the defendant fail to grant the waiver without good cause, the court will require the defendant to pay the costs incurred in making service, as well as the reasonable expenses (including attorney's fees) of any motion required to collect such expenses.¹³ The purpose of the waiver provision is to "eliminate the costs of service of a summons on many parties and to foster cooperation among adversaries and counsel."¹⁴

Federal Rule of Civil Procedure 68, on the other hand, has remained nearly unchanged textually since 1938.¹⁵ However, a pair of Supreme Court cases in the 1980s significantly broadened the scope of the rule, and two proposed amendments by the Rules Advisory Committee generated a storm of controversy that still echoes today in the reform proposals put forth by various commentators. Despite the inaction on the federal level, state level efforts to institute similar cost shifting statutes have been ongoing.¹⁶

Rule 68 provides that a defendant may make an offer of judgment to a

8. See *Marek v. Chesny*, 473 U.S. 1, 5 (1985) ("The plain purpose of Rule 68 is to encourage settlement and avoid litigation.").

9. David D. Siegel, *The New (Dec. 1, 1993) Rule 4 of the Federal Rules of Civil Procedure: Changes in Summons Service and Personal Jurisdiction*, 151 F.R.D. 441, 441 (1994).

10. These provisions replaced the previous process that allowed a plaintiff to effect actual service of process by mail in some circumstances. The intention of the change was to address concerns the earlier provision by making it clear that the request for waiver was not a formal service of process. Leslie M. Kelleher, *The December 1993 Amendments to the Federal Rules of Civil Procedure—A Critical Analysis*, 12 *TOURO L. REV.* 7, 13-14 (1995).

11. Fed. R. Civ. P. 4(d)(1).

12. Fed. R. Civ. P. 4(d)(3).

13. Fed. R. Civ. P. 4(d)(2).

14. FED. R. CIV. P. 4(d) advisory committee's note.

15. See Solimine & Pacheco, *supra* note 4, at 52.

16. See Lynch, *supra* note 5, at 354-55.

plaintiff.¹⁷ If the plaintiff refuses the offer and proceeds to trial, and at trial fails to recover as much as was offered to him by the defendant, the plaintiff must pay the defendant's costs incurred since the offer was made.¹⁸ Courts have no discretion to withhold entry of an offer of judgment or frustrate the Rule's operation.¹⁹ However, the term "costs" has generally been interpreted to include only costs paid to the court—filing fees and the like. It does not include attorney's fees, and accordingly received little attention for the first four decades of its existence.

Rule 68 came under increased scrutiny following the publication of two Supreme Court cases that defined and increased the outer boundaries of Rule 68's reach. In 1981, the Court held in *Delta Air Lines, Inc. v. August*²⁰ that the rule by its terms did not apply to a situation where the plaintiff lost after rejecting an offer, but only to cases where plaintiff prevailed for a lesser amount than was offered. Four years later, in *Marek v. Chesny*,²¹ the Court held that in the context of litigation proceeding under a statute providing for fee-shifting in the event of a plaintiff's victory, the attorney's fees should be treated as a cost. Accordingly, in most civil rights cases, should a plaintiff prevail for less than the amount of a Rule 68 offer, the plaintiff will not be able to collect attorney's fees from the defendant for work done after the offer was made.

The Rules Advisory Committee made two proposals to amend Rule 68, neither of which was implemented. In 1983 the Committee proposed to amend the rule to allow offers by either side, and to provide that reasonable attorney's fees be included in the measure of costs.²² In 1984, the Committee proposed an amendment that would abandon the use of the final judgment to determine whether a refusal to settle was unreasonable; instead, the amended rule would have allowed the court to impose "an appropriate sanction" if an offer was rejected unreasonably.²³

Rule 68 has been subject to considerable efforts of analysis, including efforts to calculate its likely effects on settlement,²⁴ efforts to measure empirically such effects,²⁵ and a myriad of reform proposals.²⁶ As discussed further below, the general consensus is that the rule has had little effect in practice, and must be revised in order to accomplish the goal of promoting settlement. I will argue that the rule already applies to the class of cases where it is most likely to have a

17. Fed. R. Civ. P. 68(a).

18. Fed. R. Civ. P. 68(d).

19. *Mallory v. Eyrich*, 922 F.2d 1273, 1278 (6th Cir. 1991).

20. 450 U.S. 346 (1981).

21. 473 U.S. 1 (1985).

22. See 1983 Proposal, *supra* note 4, at 361-63.

23. See 1984 Proposal, *supra* note 4, at 432-33.

24. See generally Miller, *supra* note 3; Bebchuk & Chang, *supra* note 3.

25. See JOHN E. SHAPARD, LIKELY CONSEQUENCES OF AMENDMENTS TO RULE 68, FEDERAL RULES OF CIVIL PROCEDURE (1995); Harold S. Lewis, Jr. & Thomas A. Eaton, *Rule 68 Offers of Judgment: The Practices and Opinions of Experienced Civil Rights and Employment Discrimination Attorneys*, 241 F.R.D. 332 (2007); Albert Yoon & Tom Baker, *Offer-of-Judgment Rules and Civil Litigation: An Empirical Study of Automobile Insurance Litigation in the East*, 59 VAND. L. REV. 153 (2006); Russell C. Fagg, *Montana Offer of Judgment Rule: Let's Provide Bonafide Settlement Incentives*, 60 MONT. L. REV. 39, 43 (1999); Lynch, *supra* note 5.

26. See Bonney et al., *supra* note 4, at 414-27.

positive effect, and that expanding its reach will likely cause more harm than good. The problems the rule faces are not the result of a failure to identify the proper mathematical formula for determining a reasonable settlement offer: they are the result of the fact that a reasonable settlement offer can't be identified by use of mathematics alone.

II. EXAMINING RULE 4

A. General Operation

Rule 4(d) is explicitly grounded on the principle that a defendant who has been given actual notice of a case should avoid imposing unnecessary costs related to the service of process on the plaintiff.²⁷ It does so by imposing the cost of service on a defendant who refuses to waive service without good cause.²⁸ The cost is imposed without regard to the ultimate resolution of the case, and the defendant knows at the time of the waiver decision about the likely consequences.

Plaintiffs and defendants are of course free to stipulate to service of process and extensions of deadlines without explicit reference to Rule 4(d). They can, on their own accord, grant extensions of time and agree to waive service, if they are inclined to cooperate with each other. However, the Rule provides an additional incentive by shifting the cost of service: without the rule the defendant weighs the benefit of additional time against the waiver of service, while under Rule 4(d) the defendant weighs the value of a time extension and avoiding paying the cost of service against the value of forcing the plaintiff to arrange service of process.

Put another way, a defendant receiving mailed notice of a case faces a different decision under the 4(d) rule than she did before. Without Rule 4(d), the defendant made her decision based solely on whether she would prefer to have extra time to respond or to receive formal service. If she didn't feel that the extra time was particularly important, the defendant might choose not to waive either because she believed plaintiff would be unable to effect service, or simply to impose a cost on her adversary. Under Rule 4(d), the defendant chooses between taking the extra time or paying the fee for the service her opponent effects on her. The defendant no longer has the option of inflicting the costs of service on the plaintiff.

Rule 4(d) has a limited impact because the cost of service of process is relatively minor compared to the cost of litigating most federal cases.²⁹ However, Rule 4(d) does have several positive attributes. First, it is based on a clear, defensible normative judgment that a defendant who has been given actual notice of a case should not insist on the formality of service of process. Second, the defendant who is presented with the option of waiving the service of process knows at the time that she makes her decision what the consequences of failing to waive will be. Finally, it is encouraging cooperation in an area that is ancillary to the case—the parties can work together to avoid paying a fee to a process server without ceding any ground on their substantive claims.

27. FED. R. CIV. P. 4(d)(1) (“An individual, corporation, or association that is subject to service under Rule 4(e), (f), or (h) has a duty to avoid unnecessary expenses of serving the summons.”).

28. Fed. R. Civ. P. 4(d)(2).

29. Siegel, *supra* note 9, at 457.

Although it is tempting to think that Rule 4(d) is harnessing the value of an extension of time to encourage the cooperation of the defendant, this is a mistake, as discussed below.

B. Illusory Impact of Time Extension

It is tempting to think of Rule 4(d) as giving the defendant an incentive to comply by offering a significant extension of the time to respond to a complaint.³⁰ However, this is an error. Plaintiffs already had the option of offering to stipulate to an extension of time in exchange for a waiver of service; the rule provides some value in standardizing the offer, but the only new incentive created is the shifting of the costs of service. The rule does not truly leverage the value of the extension of time, and in fact it is in precisely those cases where the time to respond (or waiver of service) is most important that we would expect to see the rule to have the least application.

This apparent paradox arises because litigation is a zero sum game. The value to the defendant of extra time to respond to a complaint—setting aside any incidental value derived from improving defendant's counsel's quality of life—must come from the increased quality of the defense that it can put on, which will ultimately result in a smaller award for plaintiff. Because the use of the waiver process is optional, in the cases where defendant would be most eager to trade waiver for an extension of time, plaintiff will be most reluctant to offer such a trade.

This point can be illustrated through a simple example. Consider a complex, high stakes lawsuit. If given three weeks to prepare a defense, defendant will be able to present an argument likely to lead to a settlement at \$2 million. On the other hand, if given two months to research the facts surrounding the case, craft a narrative, and generally improve the quality of her arguments, defendant will be able to present an argument likely to lead to a settlement of \$1.95 million. Setting aside the question of fees and whether this is a good use of defendant's counsel's time, we can see that defendant will leap at the chance to waive service of process—she would much rather save \$50,000 in settlement costs than inflict a process server's fee on the plaintiff of around \$500. Of course, defendant will never get that chance. The plaintiff would be a fool to offer waiver when doing so will cost him \$50,000.³¹

Similarly, Rule 4 provides that waiver of service is optional for the defendant as well. Other than avoiding the costs of service, the plaintiff derives value from the waiver to the extent that it makes it more likely that the plaintiff will be able to recover an award from the defendant. Accordingly, those cases where the plaintiff most strongly desires the defendant to waive service are the cases where the

30. See, e.g., Kenneth A. Manning & Kevin M. Hogan, *State or Federal Court?: The Commencement or Removal of Civil Cases in New York*, 1999 FED. CTS. L. REV. 5, II.D.4 n.34 (“This process actually provides an incentive to the defendant to waive service because it extends the time in which defendant has to answer . . .”).

31. The rule also suffers from the practical problem that if the plaintiff does make an offer of waiver to the defendant, the defendant will be able to extract nearly as much time to respond by simply waiting out the period of time given to consider a waiver as she would receive by waiving service. Siegel, *supra* note 9, at 456-57; Kelleher, *supra* note 10, at 19.

defendant will be least likely to do so. Plaintiff will be happy to offer the opportunity of waiver to a defendant debtor who is avoiding service in the hopes that plaintiff will give up on collecting on a judgment, but defendant is hardly likely to be moved to waive service by the prospect of extra time to respond.

The foregoing analysis does not imply that most parties will not waive service of process. In the majority of cases, where time extensions are freely granted and service of process is a mere formality, we would expect to see waiver as a matter of course. Rule 4(d) operates to allow cooperation in situations where the only obstacle to cooperation is spite, by removing the ability of the defendant to stick plaintiffs with the bill for service of process. However, in the exceptional cases where the time granted or the waiver of service that make up the Rule 4(d) bargain are particularly valuable to the parties, the zero sum nature of the contest will prevent the parties from cooperating.

Any incentive the rule creates that does not derive from the cost savings of avoiding service—that is, any incentive that affects the merits of the case—cannot give something to one side without taking it from the other. A strong incentive for one side to participate will lead to a strong incentive for the other party to avoid the rule. Accordingly, as long as participation in the rule is voluntary, we should only expect to see the rule used in relatively low stakes situations.

III. EXAMINING RULE 68

Rule 68 differs from Rule 4(d) in several ways that render it more problematic in rationale and application. It first imports a normative value more contestable than the idea that a defendant given actual notice of a case should waive formal service of process.³² It also requires a plaintiff to evaluate an offer before knowing the consequences of rejecting the offer.³³ Finally, it creates a penalty that is bound up in the overall results of the litigation, rather than a sanction that is imposed regardless of the outcome of the case. These differences in Rule 68 create problems with the application of the rule, problems that will likely grow if the rule is expanded in scope.

Rule 68, like Rule 4(d), encourages the parties to cooperate in order to receive a benefit that was already available in the absence of the rule. Rule 4(d) encourages the parties to avoid paying a fee to a process server, while Rule 68 ostensibly encourages settlement, which will allow the parties to avoid paying fees to their attorneys. Just as Rule 4(d) did not create the savings available by waiving service of process, Rule 68 did not create the savings that parties enjoy by settling a case—these savings are available to any parties that settle a case, whether or not a Rule 68 offer is involved. Rule 4(d) encourages the parties to cooperate by putting the cost of not cooperating on the defendant who has received notice of the case—that is, on the party in a position to cooperate, that the rule explicitly states has a duty to avoid unnecessary costs. Rule 68 appears to do something similar by putting the cost of a failure to cooperate on a party who unreasonably refuses to settle. However, as discussed below, the shift from a sanction for “failure to

32. FED. R. CIV. P. 68(d) (defining refusal of an offer as worthy of imposing costs whenever the offer exceeds the final judgment).

33. FED. R. CIV. P. 68(a) (requiring that offer be made fourteen days before the date set for trial).

cooperate” to a sanction for “unreasonable failure to cooperate” creates significant problems.³⁴

A. Hidden Normative Judgment

Rule 68 appears to operate based on the normative value of simply encouraging settlement.³⁵ However, it operates by punishing plaintiffs for rejecting certain settlement offers. Accordingly, it is more accurate to describe the rule as making the normative claim that parties should not reject reasonable settlement offers, and further defining settlement offers as reasonable if they exceed the amount that the party is able to secure on final judgment. This definition of “reasonability” is troubling.³⁶

The use of the ultimate result at trial to determine whether a settlement offer was reasonable is a classic example of using *ex post* results to judge *ex ante* decisions. The failure to distinguish between the information available to a judge after the jury returns its verdict and a party considering a pre-trial offer results in unfairness and fails to align the incentives of the parties in the manner apparently contemplated by Rule 68. Consider a classic “swearing contest”: a contract dispute between two equally reputable parties. The plaintiff claims that their verbal contract included term A, while defendant insists that it did not. No other evidence exists that would lead one to believe one way or another about the inclusion of term A, and in common dealings it is roughly as common for contracts to include term A as it is to leave the term out. If term A was included in the contract, plaintiff is entitled to \$100,000, while if it was not, plaintiff is entitled to nothing.

Before trial, this dispute is properly regarded as a coin flip. The jury will make a decision based on which witness it finds more credible, but there is no particular reason for plaintiff to expect the case to come out one way or the other. Suppose that in this situation defendant makes a settlement offer of \$20,000.

Unless plaintiff is highly risk averse, he is quite likely to reject the offer. A fifty-fifty shot at \$100,000 is worth roughly \$50,000.³⁷ Accordingly, nearly all plaintiffs in this situation would reject the defendant's offer. Defendant is not

34. Rule 4(d) ostensibly provides that a defendant who refuses to waive service for good cause will not be required to pay costs. However, it takes the position that courts should rarely find good cause. See Kelleher, *supra* note 10, at 17 n.54. On the other hand, Rule 68 does not explicitly invoke the concept of reasonability, but the punishment of some refusals to settle but not others implicitly makes the judgment that some refusals merit punishment while others do not.

35. *Marek v. Chesny*, 473 U.S. 1, 5 (1985) (“The plain purpose of Rule 68 is to encourage settlement and avoid litigation.”).

36. See Sprizzo, *supra* note 4, at 447 (criticizing the “presumption of unreasonableness based upon error alone.”). As discussed *infra*, from an *ex post* perspective, the refusal to settle for an amount that exceeds the ultimate judgment received is not necessarily an error.

37. Determining a precise value would require taking account of the plaintiff's level of risk aversion. Most people, being somewhat risk averse, would prefer to have \$50,000 in their pocket than a fifty-fifty chance at \$100,000. See John W. Pratt, *Risk Aversion in the Small and in the Large*, 32 *ECONOMETRICA* 122 (1964); see also KENNETH J. ARROW, *ESSAYS IN THE THEORY OF RISK-BEARING* 90 (1970) (“A risk averter is defined as one who, starting from a position of certainty, is unwilling to take a bet which is actuarially fair . . .”). For the purposes of this article I assume plaintiffs are risk neutral, or at least not so risk averse that they would prefer to have \$20,000 than a fifty-fifty shot at \$100,000.

compensating plaintiff adequately for giving up his chance at \$100,000—and if defendant wants to argue that plaintiff is avoiding the risk of getting nothing, it is equally true that by settling defendant is avoiding the risk of losing \$100,000.

Over time, plaintiffs in cases like this will consistently reject offers like the one described, but of course approximately half the time plaintiff will recover less than what defendant offered. Nevertheless, such plaintiffs have not behaved unreasonably or made some kind of mistake in valuing their cases. They have rationally evaluated the risks that they were facing, and decided on the correct course of action. To criticize them after the trial is to commit the same fallacy as a gambler who criticizes a bystander who failed to place a bet on the winning number after the roulette wheel has stopped spinning.

Put another way, defendant's offer should not be deemed reasonable when half of the time the result of the case is that plaintiff collects five times what defendant offered. Punishing a plaintiff for his *ex ante* failure to predict that this particular coin flip would go against him is unfair. A similar logic applies when we complicate the hypothetical by introducing new sources of uncertainty—more witnesses, competing visions of the case between the parties, and so forth.

In any case where the ultimate outcome is not known to the parties ahead of time, it is not reasonable to use the final judgment in determining whether an earlier settlement offer is reasonable. Each side might have their own estimates of likely ranges of outcomes and damage awards, but neither will know for sure who is right until the jury reads out its verdict. This is the world contemplated in the "swearing contest" example, and in such a world we should hardly deem the plaintiff unreasonable for failing to predict something that is impossible to predict.

A judge who has little other than the offer and the final verdict to use in judging the reasonability of a settlement offer also suffers from a lack of information. The final verdict alone does not provide enough information to know what a reasonable settlement offer would have looked like before trial. In addition, of course, it is unfair to punish a party for failing to apply a test of reasonableness that requires access to information (the final jury verdict) that is not available at the time that the party is evaluating the offer.

There is a special case where this normative assessment is defensible: if the outcome of the case is known to the parties, it does indeed appear reasonable to use the ultimate verdict to judge the reasonability of a settlement offer. After all, if the plaintiff knew that he was going to receive less money from the jury than what is currently on offer, there is no reason for him to reject the deal unless he is simply acting under the influence of hubris or attempting to engage in strategic bargaining behavior. As discussed below, it is reasonable to believe that such offers are most often made and rejected in cases where plaintiff can anticipate fee-shifting if he prevails—accordingly, it is more reasonable to apply Rule 68 in such circumstances, as current law does, than in the general run of cases.

B. Effects of the Current Restrictions on the Application of Rule 68

In the general run of cases, Rule 68 has very little effect.³⁸ It operates only to

38. See *1984 Proposal*, *supra* note 4, at 433 (noting that Rule 68 "rarely has been invoked and has been considered largely ineffective as a means of achieving its goals.").

shift court costs in most cases, which are relatively miniscule in the context of most federal litigation.³⁹ However, the rule operates with some force in the context of suits brought under fee-shifting statutes, where an offer by a defendant can operate to block the shifting of fees incurred after the offer is made.⁴⁰ The rule does not operate to shift defendant's attorney's fees to plaintiff, and defendant is not entitled to recover any costs should defendant prevail (*i.e.*, the rule only applies when plaintiff wins, but recovers less than was offered by the defendant). These restrictions on the operation of Rule 68, taken together, defuse many of the problems that a fee-shifting rule tends to create that are discussed further *infra*.

For example, the rule will have no effect in our coin flip case. If plaintiff has a fifty percent chance of winning \$100,000 and a fifty percent chance of winning nothing, defendant has no reason to make an offer that exceeds any amount that plaintiff could recover. In fact, there are only two plausible scenarios where defendant would ever make an offer in excess of a possible jury award: a case where the jury award is uncertain, or a case where the defendant has given up.

If the defendant has simply given up and made an offer in excess of anything plaintiff can win at trial, Rule 68 operates to prevent the plaintiff from refusing the offer and piling up fees that defendant must pay.⁴¹ If the jury award is uncertain, Rule 68 may operate to deprive a plaintiff who reasonably refused a settlement offer from recovering the full amount of attorney's fees he has incurred. However, the damage done by the Rule is mitigated by the fact that the plaintiff is not required to pay for the defendant's attorney.

1. Unilateral Surrender

In many cases, defendant might simply be willing to concede liability. Defendant might believe that she is going to lose, or she might not want to take the risk of having to pay not only damages, but also her opponent's legal bills.

Suppose that plaintiff is suing defendant for \$10,000, and in the process of trial plaintiff is likely to rack up an additional \$10,000 in legal bills. If she loses, defendant is facing a total bill of \$20,000 plus her own legal fees. If defendant believes that plaintiff will probably win, she will likely be happy to offer him some amount in excess of \$10,000 to settle the case. For our purposes, suppose she offers him \$11,000.

In many cases, plaintiff will be happy to take such an offer. He cannot win more money by going to trial, so acceptance nets him \$1000. However, in the context of the fee-shifting statute, the plaintiff may well be willing to reject the offer. Knowing that defendant faces a loss of over \$20,000 if she loses at trial, a hard bargainer will try to secure more of the surplus saved by avoiding trial for

39. SHAPARD, *supra* note 25, at 1.

40. The rule is used in a sizable, but not overwhelming, percentage of civil rights cases. See SHAPARD, *supra* note 25, at 8-9 (noting that a survey of 800 civil cases drawn from all the federal district court cases that terminated in the first six months of 1993 found that Rule 68 offers were made in 24 percent of the civil rights cases that settled and 12 percent of the civil rights cases that went to trial).

41. This operation of Rule 68 is similar to the original reason for the implantation of the rule identified by Professor Bone, in preventing a plaintiff from piling court costs on the defendant who surrenders. See generally Bone, *supra* note 4.

himself.

Rule 68 operates to prevent such hard bargaining by the plaintiff. If plaintiff knows that the most that he can recover at trial is \$10,000, then he also knows that by rejecting this offer he will not be able to recover attorney's fees from his opponent. Having read the statute, defendant knows this as well. Rule 68 effectively disarms plaintiff, preventing him from using the fee-shifting statute to obtain more from the defendant than his case is worth. Of course, this is hardly an unfair result—plaintiff does end up with more money in his pocket than he was ever going to be awarded by a jury.

This result is contrary to the leading economic analyses of Rule 68, which conclude that Rule 68 would have no effect when the outcome of the case is known.⁴² The reasoning goes that a plaintiff who is offered less than he expects to receive will always decline the offer without fear of sanction from Rule 68, while a plaintiff offered more than he expects to win at trial will always take the deal.⁴³ However, this overlooks the fact that plaintiff will accept an offer only if it is not only better than what he expects to receive at trial, but also better than any other offer than he could secure. In a trial conducted under the general American rule of no cost shifting, most plaintiffs in such a situation would come to that conclusion, as the settlement range—the range from the smallest offer the plaintiff should accept and the largest offer the defendant should make—will tend to center around the outcome at trial. In the hypothetical scenario given above, absent fee-shifting, the settlement range would run from \$0 (the plaintiff's winnings less his attorney's fees) to \$10,000 plus defendant's attorney's fees. If defendant's fees are equal to plaintiff's fees, the expected judgment is in the exact center of the settlement range. Accordingly, absent a large gap in bargaining ability, plaintiff has no reason to expect to obtain an offer in excess of the judgment, and should accept one if he gets it.

The economic analyses do not take into account a situation where the background rule is a one-sided fee-shifting statute. In that context, the settlement range does not center on the expected judgment at all. In fact, the expected judgment is the minimum the plaintiff will accept, because he does not bear his own fees. On the other hand, defendant should be willing to pay up to the amount of judgment plus both parties' attorney's fees and court costs in order to settle the case. Accordingly, a plaintiff who receives an offer slightly in excess of his expected judgment has every reason to believe that he can extract more money from the defendant by holding out for more.

Given the expense involved in litigating a case through a trial, defendant need not be certain of losing before surrender starts to look economically attractive (setting aside any reputational concerns defendant might have in terms of wanting to discourage future lawsuits). Consider the costs involved in *Marek*: the defendant made the plaintiff a settlement offer of \$100,000; the plaintiff later recovered \$60,000; the plaintiff incurred \$32,000 in costs before the settlement offer, and \$139,692.47 in post-offer costs.⁴⁴ If the defendant believed that \$60,000

42. See Hylton, *supra* note 4, at 79; Miller, *supra* note 3, at 104.

43. See *id.*

44. *Marek v. Chesney*, 473 U.S. 1, 3-4 (1985).

represented the upper limit of the judgment the plaintiff might secure, the defendant would have reasonably decided to make such an offer if he faced even a 45% chance of losing, even ignoring the cost of paying for the defendant's own counsel, as he would make a payment of \$100,000 to avoid the chance of making a payment of \$60,000 plus \$171,000.

The situation described in this section is one in which Rule 68's operation is an unalloyed good.⁴⁵ It prevents plaintiffs from extorting money from the defendant in excess of the amount that plaintiff could possibly win at trial.⁴⁶ However, there are other situations in which Rule 68's operation does not induce cooperation and in fact could encourage additional gamesmanship.

2. *Uncertain Damages*

Consider the plaintiff that has an iron clad case on liability, but who is uncertain as to the damages that he will recover. In this situation, it is possible that an unreasonable settlement offer (taking into account the larger award plaintiff might win) could exceed the amount that plaintiff actually recovers. This puts us in a situation where Rule 68 may operate to prevent the shift of attorney's fees even if the offer plaintiff rejects is unreasonable from an expected value point of view.

For example, suppose that plaintiff has a fifty percent chance of recovering \$10,000 and a fifty percent chance of recovering \$100,000. If defendant offers him \$20,000 to settle the case, plaintiff is all but certain to reject the offer. Plaintiff is right to do so, as the offer is well under the expected value of the case. However, should plaintiff win \$10,000, the rejected settlement offer would operate to prevent plaintiff from recovering his attorney's fees.

Even in the situation where damages are uncertain, however, it is not necessarily the case that plaintiffs only reject unreasonable offers. Imagine that defendant had offered plaintiff \$80,000 rather than \$20,000. This offer exceeds the expected value of the case, but if Rule 68 were not in place plaintiff may well reject it under the reasoning discussed above, that plaintiff feels entitled to collect more of the savings from avoiding trial.

In this situation, the negative impact of Rule 68 is at least somewhat mitigated by the fact that it does not shift defendant's fees onto the plaintiff. Rather than acting as a loser-pays system, Rule 68 creates an exception to the exception that fee-shifting statutes have created, placing the unfortunate plaintiff back under the American Rule that each party pays their own lawyer.

C. *A Happy Medium*

In many cases, the expansive availability of fee-shifting based on rejected

45. The Rule under this scenario encourages plaintiffs to take reasonable settlement offers without requiring the harsh result of charging plaintiff for defendant's attorney's fees. See Christopher W. Carmichael, *Encouraging Settlements Using Federal Rule 68: Why Non-Prevailing Defendants Should be Awarded Attorney's Fees, Even in Civil Rights Cases*, 48 WAYNE L. REV. 1449, 1467 (2003).

46. Of course, plaintiffs who are aware of the operation of the rule may take strategic steps to minimize its effect on them such as, e.g., conducting investigation, research, and as much discovery as possible as early in the life of the case as possible. See Roy D. Simon, Jr., *The New Meaning of Rule 68: Marek v. Chesny and Beyond*, 14 N.Y.U. REV. L. & SOC. CHANGE 475, 491-94 (1986).

settlement offers can create problems, as discussed in the next section. The one class of cases that does not appear problematic are the cases where plaintiff is rejecting an offer that exceeds anything plaintiff expects to collect at trial. In such cases it seems reasonable to shift costs to plaintiff or, at the minimum, to not shift costs onto the defendant.

By applying Rule 68 to attorney's fees only in cases brought under a fee-shifting statute, the Supreme Court has isolated its meaningful application only to the class of cases most likely to involve truly unreasonable refusals to settle. In most cases a plaintiff offered more than he could collect at trial would be foolish to reject the offer, but in the context of a fee-shifting statute a strategic plaintiff has the opportunity to try to extract more from the defendant. In effect, the fee-shifting statutes together with Rule 68 operate something like Rule 4(d)'s shifting of the cost of service to the party who can avoid it. Initially, the defendant is put in the position of having to pay for the costs of trial if she refuses to make a sufficiently generous settlement offer; once such an offer has been made, Rule 68 operates to put the burden of paying for the plaintiff's attorney back on the plaintiff should he refuse the offer.

Even in the context of fee-shifting cases, it is impossible to say that plaintiff is always unreasonable to reject an offer that exceeds his ultimate recovery. Plaintiff may simply have disagreed with defendant about the amount he would recover, or the uncertainty inherent in the damage award may have led plaintiff to rationally reject the offer. However, in these cases the Supreme Court's rulings limit the damage done to the plaintiff by not shifting any of the defendant's costs to the plaintiff.

The existing interpretation of Rule 68 picks the low hanging fruit by isolating the plaintiffs who are most likely to be unreasonably refusing settlement and imposing on them a sanction that removes the incentive to unreasonably refuse to settle. While there may be some improvements available to this arrangement, simply expanding Rule 68's reach is unlikely to do so.⁴⁷ The next section will describe some proposals for an expanded Rule 68, and analyze their normative and practical problems.

IV. PROPOSED REVISIONS TO RULE 68

Rule 68 has been the subject of many reform efforts, which generally suggest three sorts of changes to the rule: (1) an expansion of the costs shifted to the party who declines to settle; (2) the expansion of Rule 68 to be symmetrical—that is, to allow the plaintiff as well as the defendant to make offers that will induce cost shifting if refused;⁴⁸ and (3) adjustments to the trigger that initiates cost shifting.⁴⁹ These reform efforts are normatively problematic, and perhaps worse, will not work to increase settlement.

The expanded costs reformers would bring under the purview of Rule 68 need

47. In many ways this application to cases involving one-sided fee-shifting statutes simply acts as a modest expansion of the "unilateral surrender" principle that Professor Bone suggests was the true motivation behind Rule 68's enactment. *See generally* Bone, *supra* note 4.

48. *See* Miller, *supra* note 3, at 123-25.

49. *See* Davis, *supra* note 4, at 84-85.

not include attorney's fees. Some proposals—and state rules—shift expert witness fees only, as a sort of in between step.⁵⁰ Alternatively, some proposals take attorney's fees as a starting point, but impose a cap on the total amount shifted based on the characteristics of the settlement offer.⁵¹ As discussed below, simply expanding the costs subject to Rule 68 is not likely to encourage settlement, and results in a distribution of wealth from the plaintiff to the defendant.⁵²

Expanding Rule 68 to allow plaintiffs as well as defendants to make offers of judgment addresses the distributional issue, but does not make the Rule more likely to lead to settlement. As one party's expectations of settlement are decreased, the other party's expectations increase, so that the parties continue to bargain within a settlement range that is unchanged by the operation of Rule 68. It also may be unfair to require defendants as well as plaintiffs to evaluate Rule 68 offers, if plaintiffs tend to have more information at hand allowing them to accurately value their claims.⁵³

The most common adjustment proposed to the trigger point is to include some sort of margin of error so that plaintiff is not harshly penalized with cost shifting when a judgment is received that is close to, but less than, the offered amount. This adjustment can be made by including an explicit provision for a margin of error,⁵⁴ or by calculating costs such that the costs imposed decrease as the difference between the judgment and offer decrease.⁵⁵ However, as there is no reason to expect a reasonable settlement offer to be particularly close to the most likely judgment at trial, the inclusion of a margin of error provision is unlikely to prevent unfair application of Rule 68.

The fundamental problem with encouraging settlements by expanding Rule 68 is that Rule 68's mechanism for identifying reasonable offers—comparing them to the final judgment—is itself unreasonable in many, if not most, cases. Any uncertainty in the result or damages award will tend to separate the expected value of the case from the most likely jury award. Imposing a rule that punishes parties for rejecting unreasonable offers is problematic, but the situation is actually worse than it appears, as simply expanding the reach of Rule 68 is unlikely to increase settlement at all.

If we want to encourage reasonable settlements, it is not enough to design a rule to punish parties for rejecting reasonable settlement offers—we must also ensure that the rule encourages the other party to make reasonable offers in the first place. This is ultimately where Rule 68 fails. While Rule 4 allows the parties to cooperate on an ancillary matter where no further bargaining is necessary once defendant decides to waive service, Rule 68 encourages the parties into settlement, which is itself another zero sum game where the use of Rule 68 is simply another tool in the parties' arsenal.

The economic literature has provided several helpful analyses of the effects of

50. See Lynch, *supra* note 5, at 356-57.

51. See Schwarzer, *supra* note 4, at 151.

52. See Miller, *supra* note 3 at 103; Chung, *supra* note 3, at 275-76.

53. See John P. Woods, For Every Weapon, A Counterweapon: The Revival of Rule 68, 14 *FORDHAM URBAN L.J.* 283, 347 (1986).

54. See N.J. CT. R. 4:58-2 (providing a twenty percent buffer before cost shifting kicks in).

55. See Davis, *supra* note 4, at 84-85.

Rule 68 on the likelihood of settlement.⁵⁶ The basic insight is that while a punitive rule may encourage plaintiffs to accept a lower settlement offer, the change in circumstances will also make defendants less willing to extend generous settlement offers.⁵⁷

Formally, scholars have focused on the effects of Rule 68 on the settlement range. The settlement range runs from the smallest amount that plaintiff could receive that would exceed his expected gains at trial (*i.e.*, his expected judgment less costs and fees) to the largest amount that defendant could pay and still be better off than her expected loss at trial (*i.e.*, the expected judgment plus her costs and fees). The larger the range, the more room the parties have to settle the case, even in the face of disagreement as to the likely result of the case. Accordingly, rules that increase the settlement range tend to increase the likelihood of settlement, while rules that decrease the settlement range tend to decrease the likelihood of settlement.⁵⁸

Applying a relatively straightforward economic model to parties' behavior, it is clear that Rule 68 tends to have very little effect on the parties settlement range, even in the face of large fee-shifting awards.⁵⁹ In addition, an asymmetric application of the rule tends to result in a benefit to defendants, as one might expect from a rule that can only be invoked when defendants wish it to be.⁶⁰ This result is unavoidable with any rule that seeks to encourage one party to settle by forcing it to pay costs to the other party. To the extent that the rule makes one party more willing to accept a settlement offer, it makes the other party less willing to make an acceptable settlement offer. In addition, these reforms do not address the underlying problem of the mistake of confusing the jury verdict with a reasonable settlement offer.

I run through some hypothetical examples below to illustrate the following points: (1) the results derived from the economic analysis hold up even in situations where the parties have only rough rules of thumb to guide them rather than precise estimates of the value of their case; (2) including a "margin of error" provision is unlikely to do anything to reduce the problematic aspects of an expanded Rule 68; and (3) the problems with Rule 68 go away if the plaintiff and defendant are both certain of the result of the case, although in such a situation Rule 68 should not be necessary to induce settlement absent fee-shifting.

A. Asymmetrical Expansion of Rule 68

I begin by examining the effects of an expansion of Rule 68 to cover witness fees or attorney's fees without providing the ability of the plaintiff to trigger cost shifting to the defendant. In terms of analyzing their impact on the behavior of the parties, the distinction between shifting witness fees, attorney's fees, or partial attorney's fees derived from some formula is irrelevant. Either the amount being

56. See generally Miller, *supra* note 3; Chung, *supra* note 3; Hylton, *supra* note 4; Bebchuk & Chang, *supra* note 3.

57. See Miller, *supra* note 3, at 103.

58. See *id.* at 99-100.

59. See *id.* at 103.

60. See *id.* at 105.

awarded is not enough to affect anybody's behavior, in which case the rule doesn't matter, or it is enough, in which case the source of the award is irrelevant. Shifting different types of fees may create differences in how often Rule 68 would be relevant to the parties behavior, but not in the type of impact that it will have when it does have an impact.

In the interest of simplifying the math, I have assumed for the purposes of this section that each party will incur fees and costs of \$10,000 and that all such costs will be subject to the cost-shifting rule. Each of the hypothetical cases is set up to have an expected value for plaintiff of \$50,000.

1. *The Coin Flip*

Consider the case discussed earlier in which the only evidence is the testimony of the plaintiff and the testimony of the defendant. Neither party appears particularly credible or incredible, and the jury has no particular reason to find for one or the other. If the plaintiff wins he will receive \$120,000, while if he loses he will receive nothing.

Under a simple expected value analysis plaintiff should be willing to accept settlement offers as low as \$50,000, depending on his attitude towards risk. He has a fifty percent chance of netting \$110,000 after fees and a fifty percent chance of having a net loss of \$10,000 after fees.⁶¹ Defendant should be willing to make settlement offers of as much as \$70,000, as she has a fifty percent chance of being out only \$10,000 in fees, and a fifty percent chance of being out \$130,000 in the cost of judgment plus fees.⁶²

However, a savvy defendant will never jump right in to making an offer sincerely aimed at settling the case. Instead, she could make an offer of somewhere around \$20,000. Plaintiff will likely reject this offer out of hand, as it fails to adequately compensate him for giving up his chance at \$120,000.

But now look at what has happened to plaintiff's payouts. Instead of a fifty percent chance at winning \$110,000 and a fifty percent chance at losing \$10,000, he has a fifty percent chance of \$110,000 and a fifty percent chance of losing \$20,000 by paying both parties' fees. The simple act of making a settlement offer—even an offer defendant knew would be rejected—has reduced the expected value of plaintiff's case by \$5,000. Plaintiff should now be willing to accept an offer as low as \$45,000 to settle the case.⁶³

While this appears to have increased the settlement range (instead of \$50,000 to \$70,000 it now runs from \$45,000 to \$70,000), in fact this is an illusion. Defendant now has no incentive to offer a dollar over \$65,000, as she faces a fifty percent chance of losing \$130,000 and a fifty percent chance of losing nothing.⁶⁴

61. His chance of winning is worth $.5 * \$110,000$, or \$55,000, while his chance of losing is worth $.5 * -\$10,000$, or -\$5,000. Accordingly, his expected value is \$50,000.

62. Her chance of losing is worth $.5 * -\$130,000$, or -\$65,000, while her chance of losing is worth $.5 * -\$10,000$, or -\$5,000. Accordingly, her expected value is -\$70,000.

63. His chance of winning is still worth \$55,000, but his chance of losing is now worth $.5 * -\$20,000$, or -\$10,000. This drops his expected value to \$45,000.

64. This is consistent with the analysis by Chung showing that offers in the upper end of defendant's settlement range will be "dominated" by lower offers that leave defendant strictly better off, and accordingly will not be made. Chung, *supra* note 3, at 275.

This is a close relative of the “one dollar strategy,” in which defendant can turn an expanded Rule 68 into a general fee-shifting statute by making offers to settle a case for one dollar.⁶⁵ Such an offer will of course fail to settle the case, but it sets defendant up to collect attorney’s fees should she prevail. What we see from this hypothetical is that in some circumstances defendant can achieve the fee-shifting result of the one dollar strategy while still making what appears to be a very substantial settlement offer. A rule providing that fee-shifting is prohibited in the case of very small settlement offers or in circumstances where the final judgment is close to the offered amount will not suffice to prevent this form of gamesmanship.

2. *The Long Shot*

The situation is worse for the plaintiff with a more tenuous claim for a large damage award. Suppose that plaintiff (or his lawyer) knows, when looking at his case objectively, that he only has approximately a one in ten chance at winning. However, if he does win, he will win \$600,000. Applying our expected value calculation, he should value his claim at approximately \$50,000—90 percent of the \$10,000 he will pay in fees if he loses subtracted from ten percent of the \$590,000 he will gain if he wins.

The maximum amount that the defendant should be willing to offer to settle, absent Rule 68, is \$70,000. This puts the proper value on a ninety percent chance of paying only \$10,000 in fees and a ten percent chance of losing \$610,000.

Again defendant will have little motivation to offer plaintiff \$50,000. Instead, defendant can offer plaintiff something like \$20,000—a substantial amount that still falls substantially short of plaintiff’s expected value. We would again expect the plaintiff to reject this offer without much consideration (unless plaintiff is extremely risk averse).

Now look at the changes in the expected valuation of the case. Nine times out of ten, plaintiff will lose \$20,000, while the other time he will gain \$590,000. Plaintiff should now be willing to accept \$41,000 to settle his suit, where before he would not have accepted anything less than \$50,000. However, defendant will now be unwilling to offer anything more than \$61,000—defendant now has a ninety percent chance of paying nothing, and a ten percent chance of paying out \$610,000. Again, the size of the settlement range remains unchanged, while the numbers have shifted in the defendant’s favor.

Again, note that while it is clear to the reader of the hypothetical that defendant is engaging in gamesmanship here by making a settlement offer that he expects to have rejected in order to take advantage of the cost shifting statute, the gamesmanship is hardly transparent to a third party. An observer of the case who was not privy to the party’s assessments of the case will be hard pressed to claim that a \$20,000 settlement offer is transparently insufficient.

3. *The Sure Thing*

The plaintiff who has a surefire winner of a case will have little to fear from

65. William VanDercreek, *Civil Procedure: 1992 Survey of Florida Law*, 17 NOVA L. REV. 95, 127-28 (1992).

strategic behavior by a defendant intended to exploit a cost shifting statute.⁶⁶ Suppose that our plaintiff is a mortal lock to win \$60,000. If the defendant offers him \$20,000, \$30,000, or even \$45,000 to settle the case, plaintiff can confidently reject that offer. Because plaintiff will never win less than \$60,000 at trial, he does not have to worry about ever having to pay a portion of defendant's costs. He may consider settling for any amount exceeding \$50,000, as that exceeds his likely recovery once fees are taken into account, but he need not fear the operation of Rule 68.

On the other hand, consider what happens when the defendant offers \$61,000. Now, if the plaintiff rejects the offer, his net recovery will be not \$50,000, but \$40,000. Here, the cost shifting puts heavy pressure on the plaintiff to accept a reasonable offer, while the defendant may be motivated to make such an offer by the desire to avoid trial.

This scenario provides the best example of a fee-shifting provision working well. The fee-shifting provision operates to pressure plaintiff into accepting a reasonable offer without punishing him for rejecting an unreasonable offer. If we believe that many or most cases fit this description, then providing for significant cost shifting based on rejection of offers that exceed jury verdicts would be a practical method for reducing trial costs and encouraging settlement. However, to the extent that most cases do not fit this situation, an expanded Rule 68 would be problematic. As discussed earlier, the existing restrictions on Rule 68 limit its application to the set of cases most likely to fit this profile.

4. *A Likely Victory*

The plaintiff who is nearly certain of winning is not as well off under an asymmetric fee-shifting regime. Suppose our plaintiff feels that he will, nine times out of ten, secure a jury verdict of \$65,000. However, he believes that it is possible that he could win nothing if he is particularly unlucky in the selection of the jury and the jury's crediting of testimony, something that he estimates would happen no more than one time in ten. Using our expected value measure he would value the case at slightly under \$50,000.

Again we assume the defendant is trying to wring every possible advantage out of the settlement procedure, and makes an offer of \$20,000. This offer is far below the amount that plaintiff is nearly certain to win, but it does serve to change the expected value of the case. The one time in ten that plaintiff loses will now result in paying out \$20,000 because he will have to pay for both lawyers, not just his own.

Even in this situation, where it is very unlikely that plaintiff will lose, the simple decision to offer an amount well above zero and well below plaintiff's expected winnings will reduce the expected value of the case by \$1,000.

66. Note that this hypothetical envisions a case where the plaintiff is extremely likely to win, but that a court is unlikely to dispose of on summary judgment, perhaps because there are witnesses on both sides of the case but that both parties believe the jury is overwhelmingly likely to believe the witnesses for the plaintiff.

5. *Uncertain Damage Awards*

A similar problem arises for the plaintiff whose damage award is uncertain. Consider a plaintiff who is certain to win his case, but uncertain as to whether the jury will award him full compensation for emotional damages. Plaintiff estimates that he has a ninety percent chance of winning \$20,000, and a ten percent chance of winning \$420,000. No matter the outcome of the case, he expects to pay \$10,000 to his lawyers.

Again, plaintiff should accept any settlement offer of \$50,000 or more and again, defendant will never offer that much money to plaintiff. Instead, defendant can strategically choose to offer \$25,000. Plaintiff will reject it as falling below his expected value, and again find his case weakened in value.

Now plaintiff has a nine in ten chance of winning nothing, and a one in ten chance of winning \$410,000. The expected value of his case has fallen by \$9,000. At the same time, the maximum amount that the defendant is willing to pay will have fallen by the same amount, so there is no increase in the likelihood that the parties will settle.

6. *Summary*

When there is uncertainty as to the result of a case, expansive fee-shifting based on a comparison of settlement offers to the final result of a case often redounds to the defendant's benefit. The defendant can exploit the uncertainty inherent in most litigation to make offers that exceed plaintiff's likely recovery, but fall short of providing fair compensation for plaintiff giving up his chance at a larger recovery. Simply making such an offer can reduce plaintiff's expected valuation of the case significantly, motivating plaintiff to accept an offer that would otherwise have been unacceptable. However, while this disadvantages the plaintiff, it does not increase the likelihood that the case will settle, because at the same time that plaintiff is willing to accept less money, defendant will be less willing to make a generous offer.

B. Symmetrical Fee-Shifting

Recognizing the unfairness inherent in only shifting costs from the defendant to the plaintiff, some reformers have called for expansions of the Rule 68 principal not only to the types of costs covered, but to who can recover the costs.⁶⁷ Under these proposals, plaintiffs have the option of making a settlement offer to the defendant; if the defendant rejects the offer and plaintiff ultimately recovers more than the offered amount, plaintiff is entitled to recover additional costs from the defendant.

While this addresses the complaint of unfairness in the one-sided cost shifting scenario, it does not address the fundamental problem that the party making an offer will be motivated not to make a fair offer, but rather to make an offer that maximizes their own expected value of the case. Although strategic offer making may change the values at which each party is willing to settle the case, in the end

67. See, e.g., Miller, *supra* note 3, at 123.

the size of the settlement range remains nearly constant.

1. *The Coin Flip*

Again we return to the fifty-fifty case in which the only evidence is the testimony of the plaintiff and the testimony of the defendant. Neither party appears particularly credible or incredible, and the jury has no particular reason to find for one or the other. If the plaintiff wins he will receive \$120,000, while if he loses he will receive nothing.

As discussed previously, under a simple expected value analysis plaintiff should value his case at approximately \$50,000, depending on his attitude towards risk. However, we expect defendant to make an offer below this amount, something more like \$20,000. Plaintiff will likely reject this offer, which changes his expected result. Now, half the time he will win \$110,000 and half the time he will lose \$20,000 in paying the costs of both sides.

In the symmetrical world, plaintiff has a response available to him. He can make a counter-offer to the defendant, offering to settle the case for a payment of \$75,000. Per our calculations we would expect the defendant to reject this offer. However, it has the result of restoring our original expected value, as half the time plaintiff will win \$120,000 (his winnings and compensation for his court costs), and half the time plaintiff will lose \$20,000. Plaintiff will now be once more unwilling to accept offers below \$50,000, while defendant will again be unwilling to extend offers above \$70,000.

The net effect is to offset the changes in value due to cost shifting as the “reasonable settlement offer” test turns into a general fee-shifting statute.

2. *The Long Shot*

The plaintiff with a more tenuous claim at a large damage award does not receive as much of a benefit from the symmetrical fee-shifting regime. Per our hypothetical above, we assume that plaintiff knows, when looking at his case objectively, that he only has approximately a one in ten chance at winning. However, if he does win, he will win \$600,000. Applying our expected value calculation, he should value his claim at approximately \$50,000.

Again we expect that the defendant will offer plaintiff something like \$20,000—a substantial amount that still falls substantially short of plaintiff’s expected value. After the plaintiff rejects this offer, his expected value will fall significantly as nine times out of ten he will lose \$20,000 instead of simply paying his own fees of \$10,000.

When our plaintiff makes the tactical maneuver described above of offering to settle the case for \$75,000 (an amount greater than his expected value but less than his potential winnings), we again expect the defendant to reject the offer, setting up the potential of costs being shifted in the plaintiff’s favor. Here, however, they do not offset exactly. Instead, when both offers have been made, plaintiff is in a position where nine times out of ten he will lose \$20,000, and one time out of ten he will win \$600,000. The net result is that the minimum offer that plaintiff will accept is \$42,000. Conversely, defendant now has a nine in ten chance of no losses, and a one in ten chance of losing \$620,000, so defendant will be willing to

extend a maximum offer of \$62,000. The settlement range has shifted in defendant's favor, but remains the same size as before.

The loss in value to the plaintiff is not surprising because the fee-shifting regime is again acting like a loser-pays system. In such a system we expect the plaintiff with the tenuous but potentially high value claim to suffer, as it is less likely that he will be able to collect fees.

3. *The Sure Thing*

Neither party needs to fear any sort of gamesmanship when the outcome of the case is certain and known to both sides. Suppose that our plaintiff is a mortal lock to win \$60,000. If the defendant offers him \$20,000, \$30,000, or even \$55,000 to settle the case, plaintiff can confidently reject that offer. Because plaintiff will never win less than \$60,000, he does not have to worry about ever having to pay a portion of defendant's costs. Similarly, the defendant can confidently reject offers to settle the case at \$80,000, \$70,000, or \$65,000.

The cost shifting still operates to compel each side to accept generous offers of settlement. Consider what happens when the defendant offers \$61,000. Now, if the plaintiff rejects the offer, his ultimate recovery will be not \$50,000, but \$40,000. Similarly, imagine the plaintiff offers to settle the case for \$59,000. If defendant rejects the offer, he will wind up paying \$70,000 after the trial.

This scenario continues to provide an example of a fee-shifting provision working well. The fee-shifting provision operates to pressure both sides into accepting reasonable offers without punishing them for rejecting an unreasonable offer. Again, our only problem is determining from a third party perspective when this scenario describes what is happening in the particular case at hand.

4. *A Likely Victory*

The introduction of even a small amount of uncertainty reintroduces the role of strategic behavior. Suppose our plaintiff feels that he will, nine times out of ten, secure a jury verdict of \$65,000. However, he believes that it is possible that he could win nothing if he is particularly unlucky in the selection of the jury and the jury's crediting of testimony, something that he estimates would happen no more than one time in ten. Using our expected value measure he would value the case at slightly under \$50,000.

Again we assume the defendant is trying to wring every possible advantage out of the settlement procedure, and makes an offer of \$20,000. This offer is far below the amount that plaintiff is nearly certain to win, but it does serve to change the expected value of the case. The one time in ten that plaintiff loses will now result in losing \$10,000, rather than simply winning nothing.

However, under the regime of a symmetrical fee-shifting statute, the plaintiff has a powerful response available. He can offer to settle the case for \$63,000. Though this amount exceeds his expected value in the case, it is less than the amount he is likely to win. If the defendant rejects his offer, defendant will now be down \$85,000 in the event that plaintiff wins—\$65,000 from the judgment, \$10,000 in his own fees, and \$10,000 in plaintiff's fees. In order to settle the case now, plaintiff will expect a minimum offer of ninety percent of \$65,000 minus ten

percent of \$20,000, or \$56,500. Conversely, defendant will be willing to offer up to ninety percent of \$85,000, or \$76,500. This time the settlement range has shifted in plaintiff's favor, although again its size remains unchanged.

When the symmetrical cost shifting statute is essentially converted into a general fee-shifting statute it does not necessarily favor the defendant. Instead, it provides a windfall to the party that is more likely to prevail, on top of the amount that the party already expects to win.

5. *Uncertain Damage Awards*

The symmetrical fee-shifting regime also changes the result for the plaintiff whose damage award is uncertain. Remember the plaintiff who is certain to win his case, but uncertain as to whether the jury will award him full compensation for emotional damages. Plaintiff estimates that he has a ninety percent chance of winning \$20,000, and a ten percent chance of winning \$420,000.

Again, plaintiff's case has an expected value of \$50,000 and again, defendant will never offer that much money to plaintiff. Instead, defendant will again strategically choose to offer \$20,000. Plaintiff will reject it as falling below his expected value, and again find his case weakened in value. Now plaintiff has a nine in ten chance of winning nothing, and a one in ten chance of winning \$400,000. The expected value of his case has fallen by \$10,000.

Plaintiff can recover some of this value by making a counter-offer to the defendant, offering to settle the case for \$75,000. Now the one time out of ten that plaintiff wins the large amount, he will receive a net benefit of \$420,000. However, the fact that this scenario is so unlikely means that the increase in value that he receives is not enough to counteract the decrease caused by the defendant's offer. Again the settlement range does not change in size, but simply shifts in defendant's favor.

This scenario illustrates how a fee-shifting regime based on settlement offers can actually affect more cases than a general loser pays system. Even a triumphant plaintiff can find his victory significantly lessened unless he gives up his shot at a large jury award.

6. *Summary*

Imposing a symmetrical cost shifting regime addresses the problem of unfairness that we identified under a one-sided cost shifting regime such as a simple expansion of Rule 68. However, such a regime will have side effects that go beyond encouraging the parties to consider reasonable settlement offers. In cases with uncertain outcomes, the cost shifting regime will turn into a general loser pays system—where a “loser” is a party who receives a jury award that is worse than their expected value from the case *ex ante*—as both parties will be able to make offers that are better than the other party's worst case scenario but not sufficient to match their expected value of the case. Even in cases where the outcome is certain, if the damage award is uncertain, both parties can use that uncertainty to change the possible payouts of the case. The only scenario that is truly free of possible gamesmanship by the parties is a situation in which the outcome and damages award of the case is certain and known to the parties ahead

of time.

C. Living in an Uncertain World

The question underlying the analysis of the application of Rule 68 is this: why did the defendant make, and the plaintiff reject, an offer in excess of the amount awarded by the jury? If the defendant was simply trying to give up, concede liability, and end the case without going to trial, then it seems fair to impose sanctions on the plaintiff for refusing the offer. On the other hand, if the defendant's offer did not match up with the expected value of the case to the plaintiff, and the defendant was simply fortunate in the final outcome of the case, then it would be unfair to punish plaintiff for rejecting an unreasonable offer.

We would expect to see such surrenders tendered and rejected more often in the context of one sided fee-shifting cases, as discussed *supra* in Section III.C. A defendant faced with the prospect of paying the attorneys of both parties for a trial in which she is likely to lose will be motivated to make a generous offer in order to settle the case. Conversely, a plaintiff in such a case may be inclined to hold out for more than the likely jury award because of the pressure he knows the defendant to be under.

On the other hand, when operating under the American Rule wherein each side is responsible for paying for their own lawyer, it is difficult to conceive of a situation where a reasonable defendant would decide to make such an offer. For example, suppose that both sides knew that the plaintiff would receive \$100,000 if the case went to trial. Further, suppose that each side will face legal expenses of \$10,000 if the case were to go to trial. Knowing this, it would be reasonable for plaintiff to accept any offer over \$90,000 and for defendant to make any offer under \$110,000. This kind of flexibility in settlement range created by legal costs helps account for the frequency of settlement we observe in legal practice.⁶⁸ However, it would take a defendant who is a remarkably poor negotiator to make an offer substantially in excess of \$100,000.

In the general run of cases, settlement offers that exceed the ultimate jury reward are likely an indication of a case where the parties did not agree on the likely outcome ahead of time. In such cases it is not fair to punish the parties for their lack of future knowledge. It is only in cases where fee-shifting is present—the cases where Rule 68 currently encompasses attorney's fees—where we can expect to see a substantial proportion of offers that were made knowingly *ex ante* in excess of plaintiff's likely jury award.

V. CONCLUSION AND SUGGESTED REFORM

There is a temptation, when looking at Rule 68, to think that if we just get the math right we can get something for nothing—we can force the parties to disclose their own evaluation of the value of their case without requiring a third party to examine the evidence. After all, we can use *ex post* information in the form of the

68. See Marc Galanter & Mia Cahill, "Most Cases Settle": *Judicial Promotion and Regulation of Settlements*, 46 STAN. L. REV. 1339, 1339-40 (1994) (noting that two-thirds of cases settle without a definitive judicial ruling, while only five to fifteen percent of civil cases go to trial).

jury verdict to evaluate offers made *ex ante*. However, this is an illusion. The final verdict tells us something about the value of the case, but it does not tell us nearly enough to precisely evaluate pre-trial settlement offers, in the same way that the outcome of a football game doesn't allow us to determine what the point spread should have been.

Further improvements in incentives to settle will not come from mechanical comparisons of settlement offers to final judgments. Such comparisons are only appropriate—and helpful—when both parties know what the outcome of the case will be, and Rule 68 already applies to the subject matter areas where those cases are most likely to occur, and most likely to fail to settle.⁶⁹

Instead, any determination of the reasonableness of a settlement decision must be made by an impartial third party with an intimate familiarity with the case. The state of Michigan has had just such a process in place for over thirty years in a system that has come to be known as “Michigan mediation” (although “case evaluation” might be a more accurate term, and is indeed the term used in the Michigan Statutes today).⁷⁰

Under the Michigan Rules of Civil Procedure, a dispute may be submitted for case evaluation by stipulation, by motion of one of the parties, or on the court's initiative.⁷¹ Three people are chosen for the case evaluation panel—although a judge may be assigned to the panel, the judge presiding over the case may not be, and no evaluator may testify at the trial.⁷² The parties submit a written argument to the panel and get fifteen minutes to present their argument at a case evaluation hearing.⁷³ The panel then issues its evaluation of the case, and each party gets 28 days to decide whether to accept or reject the panel's recommendation (either party may reply earlier, but neither party's decision is revealed before the time is up).⁷⁴ If one party rejects the evaluation, the case proceeds to trial as usual. However, the party who rejected the case evaluation will be required to pay the other side's costs, including attorney's fees, unless they secure a verdict that is at least ten percent better for them than the evaluation panel's recommendation.⁷⁵

The Michigan case evaluation procedure is superior to either of the reforms proposed by the Advisory Committee. Simply expanding the reach of Rule 68, as the 1983 Proposal did, creates the problems discussed at length *supra*. The 1984 Proposal, which allowed a party to bring a claim within ten days after the entry of judgment that would allow the court to impose an “appropriate sanction” upon the party that unreasonably refused an offer, is an improvement,⁷⁶ but still forces the recipient of a settlement decision to guess in advance of trial what a judge will find unreasonable.

69. *See supra* Part III.C.

70. MCR 2.403; see Laurence D. Connor, *The Proposed New Court Rules – Modern Dispute Resolution for Michigan*, 79 MICH. B. J. 483, 486 n. 9 (2000).

71. MCR 2.403 (B)(1).

72. MCR 2.403 (D).

73. MCR 2.403 (I)-(J).

74. MCR 2.403 (K)-(L).

75. MCR 2.403 (O). If both parties rejected the evaluation, costs will only be shifted if the verdict is ten percent more favorable to one side than the recommendation. MCR 2.403 (O)(1).

76. *See* 1984 Proposal, *supra* note 4, at 432-33.

By contrast, pre-trial case evaluation allows the party faced with the settlement decision to know what the consequences of their decision will be. Just as Rule 4(d) provides that a defendant who refuses to waive service of process will be forced to pay for the cost of service, case evaluation puts the parties on notice that refusing the settlement offer will likely result in cost shifting. In addition, fixing the amount of a reasonable settlement offer puts the parties in the same position of making a simple yes or no decision as a defendant facing a request to waive service. Rather than trying to indirectly affect incentives to settle by changing trial payouts, the parties are informed directly as to what a neutral third party considers a reasonable settlement and asked to decide whether they want to take it or not. Requiring the party to beat the evaluation by ten percent in order to avoid cost shifting ensures that the parties will not go to trial unless they think the evaluators have made a substantial error.

The case evaluation method neatly cuts out the strategic behavior that would be created by simply expanding Rule 68. The parties cannot simply make an offer calculated to invoke the fee-shifting statute, but instead must convince a neutral panel of the correct valuation of the case.

This procedure is not without drawbacks. For one thing, it creates yet another obstacle that plaintiffs must overcome before getting their day in court, and may be criticized for that reason.⁷⁷ It would also represent another opportunity for judges to essentially take cases out of the hands of juries by encouraging settlement before the jury has a chance to weigh in. We also might worry about the cost of this procedure, but in Michigan each party's contribution is limited to a \$75 fee.⁷⁸

Establishing a federal case evaluation system would require amendment of the Federal Rules of Civil Procedure. The existing rules and case law prevent judges from imposing such a system using local rules,⁷⁹ although the parties may stipulate to its application.⁸⁰ Although such a system could be put in place by amending Rule 68, it would probably be better to add it in its own rule, as Rule 68 does have a separate role to play in the fee-shifting context.

The existing framework of Rule 68 operates effectively to let defendants in fee-shifting cases surrender and avoid having extra costs piled on to them at the plaintiff's option. Attempts to expand Rule 68 into a more general tool for encouraging settlement must address the problem of identifying when settlement offers are reasonable, and anticipate that parties to litigation will use such a rule in a strategic fashion to reduce their own liability if at all possible. Unfortunately, there is no single mathematical formula that can be applied to determine when settlement values are reasonable. I believe the best way to avoid perverse results from such a rule is to employ a neutral third party to evaluate the case and ensure that sanctions are only applied to parties whose refusals to settle are truly unreasonable.

77. See Edward F. Sherman, From "Loser Pays" to Modified Offer of Judgment Rules: Reconciling Incentives to Settle with Access to Justice, 76 *TEX. L. REV.* 1863, 1863-64 (1998).

78. MCR 2.403 (H). It is not clear to what extent the program is subsidized, but if it results in any noticeable reduction in cases going to trial it likely pays for itself.

79. *Tiedel v. Nw. Mich. College*, 865 F.2d 88, 94 (6th Cir. 1988).

80. *Mencer v. Princeton Square Apartments*, 228 F.3d 631, 636-37 (6th Cir. 2000).