

COMMENT ON DONOHUE

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Professor Donohue's article on the effects of fee shifting on settlement,¹ which is perhaps the most abstruse article in this symposium, certainly bears out Dean Calabresi's statement that some hold the attitude that "something may work fine in practice, but we have to show that it will work in theory."² I suppose I have been chosen to try to deal with it because of my sin of pretending to understand what George Priest was trying to teach some federal judges about economics at a conference last year.³

The topic Professor Donohue addresses is a good example of Harry Kalven's doctrine that the law is "analytically dense." Kalven meant this in the sense that the term "mathematically dense," when applied to a set of numbers, means that you can place another number between any two numbers in the set.⁴ Thus, for example, the set of integers is not dense, because you cannot put another integer between 2 and 3. The set of all real numbers, however, is dense because you can find another number between any two real numbers, no matter how small their difference. In the legal context, there usually exists a complication or an additional fact between any two concepts or rules that seem to cover a situation that creates a new situation requiring additional thought. Professor Donohue's article is a good attack on an extremely dense subject.

My remarks will be a true "comment" on Professor Donohue's article. I do not intend to debate him, but rather to raise additional questions and discuss the implications of what he has written. Too often the "Coase Theorem"⁵ is invoked to mean that the legal rule simply makes no difference. Professor Donohue does not make this mistake, but does not explicitly countermand it either. The Coase Theorem says that, with the ability to contract (and no transaction costs!), independent parties should reach the same decisions on productive processes under any rule of law. Thus the number of railroads and the amount and nature of wheat farming should not be affected by who bears the cost of fires started by railroad sparks. This does

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1. John J. Donohue, *The Effects of Fee Shifting on the Settlement Rate: Theoretical Observations on Costs, Conflicts, and Contingency Fees*, 54 L & Contemp Probs 195 (Summer 1991).

2. Remarks of Guido Calabresi, Dean of Yale Law School, delivered as an introduction to this symposium, "Modern Civil Procedure: Issues in Controversy," conducted at Yale Law School, June 15-16, 1990.

3. George Mason University School of Law, Law & Economics Center, "Advanced Course for Federal Judges on Economics of Risk, Injury & Liability," Feb 3-9, 1990.

4. Richard Courant & Herbert Robbins, *What is Mathematics? An Elementary Approach to Ideas and Methods* 58 (Oxford U Press, 1941).

5. Ronald H. Coase, *The Problem of Social Cost*, 3 J L & Econ 1 (1960).

not mean, however, that there are no wealth or allocative effects. Under a rule favoring railroads, for example, railroads will be richer and farmers poorer. Thus the rule adopted is not a matter of indifference to legislators, social philosophers, or the individuals affected.

Professor Donohue constructs his article in the context of settlements *at trial*. Courts across the country have noted that the proportion and number of cases being appealed has continued to rise, although the number of cases filed in district courts has shown signs of leveling off. Nationally, appeals have risen seven-fold since 1963, whereas cases filed in district courts have risen only three-fold.⁶ Appeals filed in 1990 constituted 14 percent of 1989's district court filings, while appeals filed in 1964 numbered only 6 percent of 1963's district court filings.⁷

Despite what the theories presented imply, an increasing number of cases can be, and are being, settled. Professor Donohue and other theorists of settlement argue that people settle because the cost of proceeding further is greater than the "uncertainty band" of outcomes.⁸ In the Sixth Circuit Court of Appeals, about 10 percent of the docket settles with staff assistance but with no court interaction. This settlement rate amounts to about 20 percent of our oral argument docket and 43 percent of the cases in which settlement is attempted by the court staff. Unless there is reduced uncertainty on appeal due to respect for the professional advice of lawyers, the low cost of appeal should mean that fewer settlements would occur. If anything, the increasing number of appellate judges (and the perception that recent presidents have chosen judges from diverse points on the legal spectrum) theoretically should lead to more uncertainty and less settlement. This point of view underestimates risk aversion. Although he treats it somewhat in passing, Professor Donohue does mention that, independent of all other factors, the higher the level of risk aversion, the more likely settlements are.⁹

At the other extreme, there are virtually no settlements at the Supreme Court level. This may be due to a stronger commitment to principle at this level of adjudication as well as to the importance of a fixed rule to all parties, both before the Court and elsewhere.

The operation of the British rule of fee shifting¹⁰ in Britain, as opposed to its potential application in America, may occur with lower litigation costs for procedural and economic reasons. Under the Donohue theories, *ceteris paribus*, low cost will result in fewer settlements independent of any other rule. This could account for a fair number of the differences in the actual results under the two systems.

6. Annual Report of the Director of the Administrative Office of the United States Courts 2, 7, 12 (Administrative Office of the U.S. Courts, 1989).

7. Annual Report of the Director of the Administrative Office of the United States Courts 96, 107, 145 (Administrative Office of the U.S. Courts, 1970).

8. See Donohue, 54 L & Contemp Probs at 197-98 (cited in note 1).

9. *Id.* at 208.

10. Under the British rule, the losing party pays the winning party's legal fees.

Furthermore, a few percentage points difference in the percentage of cases that settle may have a much greater than expected difference in the number that go to trial. Although it may appear trivial if the percentage of cases settled can be increased from 90 to 93 percent, this increase would represent a 30 percent decrease in the number of cases that go to trial.

Since 90 to 95 percent of all cases already settle, the question is not whether they were settled, but when and at what cost. A number of tentative steps have been made in the direction of allocating the parties' responsibility for their pleadings, such as sanctions under Civil Rule 11 and Appellate Rule 38, and fee shifting under Civil Rule 68.¹¹ The Equal Access to Justice Act¹² and section 1983 of Title 42 of the United States Code may also shift costs, although they are a form of "one-way" fee shifting because they rarely, if ever, can be applied in favor of the government. The courts have shown continued reluctance to push in this direction.¹³

The British rule or some other device that discourages suits altogether should be thought of as the ultimate in quick, early, and cheap settlement because it happens before the suit is even filed, takes no time, terminates the litigation, and causes no cash outlay. This method of settlement occurs when risk aversion is a dominant factor, since the plaintiff is in effect betting some of his own money in undertaking the suit.

Several of Donohue's figures¹⁴ indicate that pessimistic plaintiffs would be more likely to settle under the British rule than under the American rule and that this difference increases with the pessimism of the plaintiff. The figures also indicate that the likelihood of pessimistic plaintiffs settling under the British rule increases with the confidence of the defendant. However, these differences can mean that the small or unsophisticated plaintiff is prejudiced. The fact that lawsuits may not be filed at all when they have little merit does not necessarily mean that in the aggregate meritorious claims will be correctly assessed and compensated. If many plaintiffs each have a 10 percent chance of winning ("winning" meaning having a meritorious claim and having it so adjudicated), then a rule resulting in *none* of these cases being filed (though in some sense the correct outcome in each case) means that none of the plaintiffs will be compensated, although by definition 10 percent of their claims are meritorious.

The ability to contract around the costs and strictures of the current system represents an avenue for experimentation. In many cases, the parties can contract in advance to use arbitration and other means of alternative dispute resolution, and there is no reason that fee-shifting rules cannot be incorporated into such agreements. Parties already must bear the

11. FRCP 11; FRAppP 38; FRCP 68.

12. 28 USC § 2412 (1988).

13. See, for example, *Shaw v Delta Airlines*, 463 US 85 (1983) (on Rule 68); *Christianburg Garment Co. v EEOC*, 434 US 412 (1978) (expressing extreme reluctance to impose costs on civil rights plaintiffs); *Lotz Realty Co. v US Dep't of Housing*, 717 F2d 929 (4th Cir 1983) (same).

14. Donohue, 54 L & Contemp Probs Figures 3-5 at 220-21 (cited in note 1).

institutional cost of the arbitrator or "rent-a-judge," and this allocation of cost represents at least a leaning in the direction of the British rule.

As an aside, I would mention a possible idea for encouraging settlements from the world of game theory, the concept of the "Schelling Point,"¹⁵ named for Professor Thomas Schelling of Harvard. Under this concept, the prominence of certain facts or features may facilitate agreement. For example, two parties may be unable amicably to divide a featureless plain or desert, but could agree to a division if a river line divides it. Two tourists in Paris are more likely to be able to agree to meet at the Arc de Triomphe than at any random location on a street grid. Legal rules that could help establish such points might make outcomes of some disputes more certain and settlement more likely. In one sense, some common law rules, such as the old admiralty rules of "divided damages"¹⁶ and "general average,"¹⁷ or a rule of equal division of fault when there is contributory negligence, could be seen as examples of the Schelling concept.

All ideas and analysis helpful to the process of settlement need to be pursued vigorously. Professor Donahue's article is a valuable contribution to that effort.

15. Thomas C. Schelling, *The Strategy of Conflict* 53-58 (Harvard U Press, 2d ed 1980).

16. The divided damages doctrine provided that whenever two or more parties involved in a maritime accident were both guilty of contributory fault, the damages were allocated equally to the parties, regardless of the relative degree of their fault. *The Schooner Catharine v Dickson*, 58 US (17 How) 170, 177-78 (1854), overruled by *United States v Reliable Transfer Co.*, 421 US 397, 411 (1975).

17. "General average" applies when some portion of a ship's cargo must be jettisoned to save the ship. Owners of cargo not jettisoned must pay the lost cargo's owner in proportion to the value of the surviving cargo, to the extent of the cargo owner's loss. *United States v Atlantic Mutual Ins. Co.*, 343 US 236, 246 n15 (1952).