The Litigation Budget

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Because of fears that litigation is too costly, reduction of litigation expenses has been the touchstone of procedural reform for the past thirty years. In certain circumstances, however, the parties have incentives—both rational and irrational—to spend more on a lawsuit than the social benefits that the case provides. Present and proposed reform efforts do not adequately address these incentives, and, in some instances, exacerbate the parties' incentives to overspend. The best way to ensure that the cost of a lawsuit does not exceed the benefits that it provides to the parties and society is to control spending directly: to require the parties to file and live within litigation budgets. These "costs budgets," which are already in use in the United Kingdom, help to ensure that the costs of litigation remain less than the benefits. After describing the workings of a costs-budget system, the Article considers practical, political, and constitutional critiques. None of these concerns is disabling. American rulemakers who are serious about containing the litigation costs should grant courts the power to use costs budgets.

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I. INTRODUCTION

A controversial set of amendments to the Federal Rules of Civil Procedure will likely come into effect within six months.[1] A principal object of the proposed changes is to limit the amount of information that parties can obtain during discovery.[2] No one who is advocating

1. The Judicial Conference of the United States has approved the amendments, which are now pending before the Supreme Court. The Court is expected to approve the amendments in April 2015, with an effective date of December 1, 2015. Although Congress may enact legislation preventing the implementation of amendments to the Federal Rules, *see* 28 U.S.C. § 2074(a) (2012), it rarely does so. The progress of the amendments through the rulemaking process can be followed on the website of the Administrative Office of the United States Courts at *Pending Rules Amendments*, U.S. COURTS, http://www.uscourts.gov/RulesAndPolicies/rules/pending-rules.aspx, *archived at* http://perma.cc/B3XU-JBEU (last visited Jan. 14, 2015).

2. *See* Memorandum from the Honorable David G. Campbell, Advisory Comm. on Civil Rules, to the Honorable Jeffrey S. Sutton, Chair, Comm. on Rules of Practice and Procedure 3 (May 2, 2014), *available at* http://www.lfcj.com/uploads/3/8/0/5/38050985/civil_rules_advisory_comm__report_to_standing_committee_may_2014.pdf, *archived at* http://perma.cc/KM8D-P62Q (noting that the goal of the amendments is to "reduc[e] cost and delay[ ] by advancing cooperation among the parties, proportionality in the use of available procedures, and early and active judicial case management"). Specifically, a proposed amendment to Rule 26 would eliminate a party's ability to obtain discovery "relevant to the subject matter involved in the action." *Compare* FED. R.

discovery limitations is suggesting that party access to information is inherently bad.[3] In theory, more information should lead to a better resolution of a dispute. The perceived problem is that obtaining information can be expensive, so that, in the eyes of some, the value of the information discovered is not always worth its cost.[4]

This impulse—to prevent excessive expenditure on litigation—also underlies recent judicial efforts to raise the pleading bar. Noting that "proceeding to . . . discovery can be expensive"[5] and that "the success of judicial supervision in checking discovery abuse has been on the modest side,"[6] the Supreme Court has imposed a "requirement of plausibility" on complaints filed in federal court.[7] If parties could obtain

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CIV. P. 26(b)(1) (permitting this discovery on a showing of "good cause"), *with* Memorandum, *supra*, at 20 (recommending an amendment that eliminates "subject matter" discovery). Another amendment emphasizes the need for discovery to be proportional to the lawsuit. *Id.* (proposing to amend FED. R. CIV. P. 26(b)(1), (b)(2)(C)(iii)). A third makes clearer the court's power to require a requesting party to pay for discovery. *Id.* at 20–21 (proposing to amend FED. R. CIV. P. 26(c)(1)(B)).

In addition to these amendments to Rule 26, the Advisory Committee considered other limitations on discovery. *See* COMM. ON RULES OF PRACTICE AND PROCEDURE OF THE JUDICIAL CONFERENCE OF THE U.S., PRELIMINARY DRAFT OF PROPOSED AMENDMENTS TO THE FEDERAL RULES OF BANKRUPTCY AND CIVIL PROCEDURE (2013), *available at* http://www.ediscoverylaw.com/files/2013/11/Published-Rules-Package-Civil-Rules-Only.pdf, *archived at* http://perma.cc/TN8L-BWK3. These proposals included reducing the number of depositions from a presumptive maximum of ten to a presumptive maximum of five and the presumptive length of the deposition from seven hours to six, *id.* at 300–01, 303 (proposing to amend FED. R. CIV. P. 30(a)(2)(A)(i), 30(d)(1), and 31(a)(2)(A)(i)); reducing the presumptive number of interrogatories from twenty-five to fifteen, *id.* at 305 (proposing to amend FED. R. CIV. P. 33(a)(1)); and imposing a presumptive limit of twenty-five requests for admission, *id.* at 291, 310–11 (proposing to FED. R. CIV. P. 26(b)(2)(A) and to add new Rule 36(a)(2)). These proposals were not voted out of the Advisory Committee. Memorandum, *supra*, at 3.

3. Discovery raises concerns about the disclosure of trade secrets or other confidential information. *See* Arthur R. Miller, *Confidentiality, Protective Orders, and Public Access to the Courts*, 105 HARV. L. REV. 427, 464–74 (1991) (describing harms to privacy and property interests caused by broad discovery). These concerns did not appear to motivate the present proposals to constrict discovery; rather, the concern was to keep the costs of discovery proportional to the nature of the case. *See* COMM. ON RULES OF PRACTICE AND PROCEDURE OF THE JUDICIAL CONFERENCE OF THE U.S., REPORT OF THE JUDICIAL CONFERENCE COMMITTEE ON RULES OF PRACTICE AND PROCEDURE TO THE CHIEF JUSTICE OF THE UNITED STATES AND MEMBERS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES 18 (2013), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Reports/ST09-2013.pdf, *archived at* http://perma.cc/UHW8-QN7R (noting that the proposed amendments responded to calls to "reduc[e] cost and delay in civil litigation").

4. *See* Memorandum, *supra* note 2, at 5–10 (detailing reasons for curtailing certain discovery, and noting "widespread support . . . for the proposition that discovery should be limited to what is proportional to the needs of the case").

5. Bell Atl. Corp. v. Twombly, 550 U.S. 544, 558 (2007).

6. *Id.* at 559.

7. *Id.* at 560; *see also* Ashcroft v. Iqbal, 556 U.S. 662, 678–79 (2009) (detailing the analysis used to determine if a complaint meets the "plausibility standard"). *Iqbal* involved a lawsuit against government officials. Although the case did not involve information whose discovery would have been expensive in monetary terms, the Court noted other costs that the "plausibility" bar helped to avoid: "Litigation, though necessary to ensure that officials comply with the law, exacts

information at modest cost, this restrictive approach to pleadings would be unnecessary.

The same story could be told over and over. The central theme in the past thirty years of American procedural reform—with its rise of case management and its emphasis on proportional discovery—has been the effort to keep litigation costs under control.[8] As the frequent waves of reform suggest, the effort to date appears not to have been especially successful.[9] One reason may be that rulemakers are responding to the myth of outsized litigation costs rather than to the reality of a system that functions reasonably well.[10] To the extent that a "litigation cost" problem exists, however, the reason for the persistence of excessive cost is evident: rulemakers are trying to cure the symptoms rather than the disease. If the goal of heightened pleading, limited discovery, and case management is to reduce costs,

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heavy costs in terms of efficiency and expenditure of valuable time and resources that might otherwise be directed to the proper execution of the work of the Government." *Id.* at 685.

8. Amendments in the Federal Rules of Civil Procedure in 1980, 1983, 1993, 2000, and 2006 were principally designed to accomplish the related aims of limiting discovery and enhancing judicial power to manage litigation. *See* Stephen N. Subrin & Thomas O. Main, *The Fourth Era of American Civil Procedure*, 162 U. PA. L. REV. 1839, 1850 (2014) ("Since 1980, the Federal Rules have been amended numerous times: the scope of discovery was narrowed; numerical limits restricted the amount of discovery; and new discovery conferences, pretrial conferences, mandatory disclosures, and sanction rules encouraged closer judicial supervision of discovery."). In addition to the Supreme Court's decisions on motions to dismiss, *see supra* notes 5–7 and accompanying text, the Court's decisions recognizing an expanded role for summary judgment, *see, e.g.*, Celotex Corp. v. Catrett, 477 U.S. 317, 327 (1986), also fit into the same mold.

9. Although it is still early to measure the effect of *Twombly* and *Iqbal*, the preliminary data do not reflect a significant change in federal practice. *See* JOE S. CECIL ET AL., MOTIONS TO DISMISS FOR FAILURE TO STATE A CLAIM AFTER *IQBAL*: REPORT TO THE JUDICIAL CONFERENCE ADVISORY COMMITTEE vii (2011), *available at* http://www.fjc.gov/public/pdf.nsf/lookup/motioniqbal.pdf/$file/motioniqbal.pdf, *archived at* http://perma.cc/E32T-3UQW (noting that, although the rate of filing motions to dismiss rose after *Twombly and Iqbal*, the rate at which motions to dismiss were granted remained unchanged except in one narrow category of cases); JOE S. CECIL ET AL., UPDATE ON RESOLUTION OF RULE 12(b)(6) MOTIONS GRANTED WITH LEAVE TO AMEND 5 (2011), *available at* www.fjc.gov/public/pdf.nsf/lookup/motioniqbal2.pdf/$file/motioniqbal2.pdf, *archived at* http://perma.cc/24U6-EQ32 (confirming these findings, but noting that the "findings do not rule out the possibility that the pleading standards established in *Twombly* and *Iqbal* may have a greater effect in narrower categories of cases in which respondents must obtain the facts from movants in order to state a claim"). Similarly, the 2000 amendment to Rule 26, which was designed to curtail the discovery of information relevant to the "subject matter" of a case, had minimal effect. *See* Thomas D. Rowe, Jr., *A Square Peg in a Round Hole? The 2000 Limitation on the Scope of Federal Civil Discovery*, 69 TENN. L. REV. 13, 25 (2001) (noting that "plaintiffs have not been doing at all badly" despite the restriction).

10. For studies suggesting that the discovery process generally performs well and that its difficulties are confined to a small subset of cases, see James S. Kakalik et al., *Discovery Management: Further Analysis of the Civil Justice Reform Act Evaluation Data*, 39 B.C. L. REV. 613, 682 (1998); Thomas E. Willging et al., *An Empirical Study of Discovery and Disclosure Practices Under the 1993 Federal Rule Amendments*, 39 B.C. L. REV. 525, 527 (1998). *But see* Memorandum, *supra* note 2, at 6–7 (describing surveys that suggest the cost of discovery is disproportionately high, especially in small cases).

then rulemakers should do so directly. They should limit the amount of money that litigants can spend on a lawsuit.

The method for doing so is simple. Before the first case conference, each party should submit a budget detailing the costs that the party expects to incur in the case. After examining both budgets as well as the nature of the case, the court should determine the amount of money that each party can spend and enter an order requiring the parties to stay within their budgets.[11]

This "litigation budget" approach may sound fanciful, but British courts implemented it in 2013.[12] Because British courts typically use the English (or loser-pays) rule,[13] the court has a stick with which to enforce the parties' compliance with its budget order: it will generally award a winning party no more in fees and costs than the amount approved in the budget.[14] Because American courts typically employ the American rule, under which each party bears its own fees and most of its own costs,[15] adapting the British approach to the American system requires practical adjustments that raise practical, political, and constitutional concerns.

This Article examines these issues. Part II sets out the nature of the overspending problem that litigation budgeting seeks to solve. Part III describes the British approach and adapts it to a system that could effectively alter the incentives of American litigants to overspend. Part IV responds to a series of objections to litigation budgets.

Litigation budgeting is simple, and it is radical. Some will argue that it is an impermissible and unwise exercise of judicial power. The ultimate questions that this Article poses are these: If direct control of

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11. Like other pretrial orders, the court can modify the order. *See* FED. R. CIV. P. 16(b)(4), (d).

12. CPR 3.12–.18 (2014). In English practice these budgets are called "costs budgets."

13. *See* CPR 44.2(2)(a) ("[T]he general rule is that the unsuccessful party will be ordered to pay the costs of the successful party."); *see also* CPR 44.2(1) (giving the court discretion whether to award costs and what the amount of the award will be).

14. CPR 3.18 (2013) ("[W]hen assessing costs on the standard basis, the court will . . . not depart from such approved or agreed budget unless satisfied that there is good reason to do so.").

15. *See* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975) (describing the American rule). Winning parties can collect modest costs in federal court. *See* 28 U.S.C. § 1920 (2012). Despite the prevalence of the American rule, federal courts employ a loser-pays approach in many circumstances. For a comprehensive list of federal fee-shifting provisions, see HENRY COHEN, CONG. RESEARCH SERV., 94-970, AWARDS OF ATTORNEYS' FEES BY FEDERAL COURTS AND FEDERAL AGENCIES 2–115 (2008) (describing approximately four hundred fee-shifting statutes, as well as fee-shifting provisions at common law and under the Federal Rules of Civil Procedure). The only American state generally to employ a loser-pays rule is Alaska. *See* ALASKA STAT. ANN. § 09.60.010 (West 2014); *see also* TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 (West 2013) (permitting fee shifting in a range of civil matters); Stephen B. Burbank et al., *Private Enforcement*, 17 LEWIS & CLARK L. REV. 637, 650–51 (2013) (discussing the general use of the American rule in state courts).

litigation costs by means of budgets is too radical, then are the indirect methods of control adopted over the past thirty years also illegitimate? Conversely, if directly controlling costs is not too radical, why not do so rather than continuing to use indirect methods that have proven (at best) marginally effective?

II. EXCESSIVE SPENDING ON LITIGATION

Finding a solution to excessive litigation costs begins with an understanding of the reasons that parties spend too much. Excessive spending can arise from two causes. First, the parties' private incentives to invest in litigation may diverge from the socially optimal level of investment. Because the parties do not internalize all of the costs of their litigation decisions, decisions to incur certain expenses may be economically justified from a party's viewpoint even if the total of the litigation expenses incurred by all the parties is socially wasteful. Second, the parties may make litigation investments that are not economically rational—in other words, they cannot rationally expect that their litigation investment will change the value of the case by an amount greater than the money they expend, but they make the investment anyway.

The following sections analyze these circumstances in detail. They also demonstrate that the pleading and pretrial reforms of the past thirty-plus years—as well as present reform proposals—are destined to fail as mechanisms to control litigation costs because they fail to address the causes of excessive spending.

Before undertaking this analysis, let me make the basic point that underlies this Article: litigation should not cost more than the benefit it provides to society.[16] To take a simple example, if the expected

16. This principle is most evidently grounded in the economic notion of Pareto superiority, as modified by the Kaldor-Hicks principle. *See* THOMAS J. MICELI, THE ECONOMIC APPROACH TO LAW 4–6 (2004) (discussing Pareto improvements and Pareto optimality and the Kaldor-Hicks, or "potential Pareto superiority," refinement). But the principle is also consonant with various strands of moral theory. It is obviously supported by utilitarianism, under which actions that bring the greatest good to the greatest number are morally preferable. Walter Sinnott-Armstrong, *Consequentialism*, *in* THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., Spring 2014 ed.), *available at* http://plato.stanford.edu/archives/spr2014/entries/consequentialism/, *archived at* http://perma.cc/BAQ2-C6KT. But the principle can be justified by other moral traditions. For instance, limiting litigation spending to a socially justified level can be derived from Mill's Harm Principle, which holds that one person's liberty to act ends at the point at which the person's actions impose undue costs on others. *See* JOHN STUART MILL, ON LIBERTY 30 (John Gray & G.W. Smith ed., 1991) (1859) ("[T]he only purpose for which power can be rightly exercised over any member of a civilized community against his will[ ] is to prevent harm to others."). Mill derived the Harm Principle from his utilitarian philosophy, but some have argued that "the Harm Principle is more properly regarded as . . . based on Kant's doctrine of right." William E. O'Brian, Jr., *Distributive Justice and the Sovereignty Principle*, 31 OXFORD J. LEGAL STUD. 1, 2 (2011).

social value of a victim's claim is $10,000, but it costs the victim, the injurer, and the court $7,000 apiece to litigate the dispute, then litigation is socially wasteful; it costs $21,000 to recover $10,000.

It is important to consider this question from the viewpoint of social, rather than private, benefits and costs.[17] On the one side, the social benefits of the victim's lawsuit may include positive externalities that exceed the $10,000 judgment received by the plaintiff. For instance, the judgment may have a deterrent effect that keeps other actors' behavior in line.[18] Likewise, if the case involves uncertain law, clarifying the law may have social benefits.[19] On the other side, the social costs of litigation may exceed $21,000 due to negative externalities associated with the lawsuit. For instance, the threat of litigation may deter actors from engaging in socially useful behavior. Regardless of what is thrown onto the "benefit" and "cost" sides of the scale, the principle is simple: litigation whose social cost exceeds its social benefit generally should be discouraged.[20]

A. The Incentive to Engage in Privately Beneficial but Socially Wasteful Litigation Practices

A principal cause of socially excessive spending on litigation is the myopia of self-regarding litigants who are willing to spend money

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Limiting litigation expenditures is also consistent with (albeit not required by) Rawls's veil of ignorance: people who do not know which position they will occupy in society (litigant willing to spend excessively, litigant preferring not to spend excessively, judge, or citizen) would likely prefer that costs be kept to a socially justified level. *See* JOHN RAWLS, A THEORY OF JUSTICE 136–42 (1971) (positing a "difference principle" under which a society may legitimately maintain inequalities in the distribution of basic social goods only if members of the society, operating from behind a veil of ignorance, would all agree to the inequality).

17. In this Article, the term "social benefits" refers to the combined benefits that litigation provides to the private individuals involved in the litigation *and* to society. When referring only to the benefits to society, I use the term "public benefits." Likewise, the term "social costs" includes both the costs incurred by the litigants and the costs imposed on society. When referring only to the costs to society, I use the term "public costs."

18. *See* Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575, 585 (1997) (showing that "it may be socially desirable for more to be spent on suit than the amount at stake" when a lawsuit "create[s] substantial deterrence" that leads actors to take steps to reduce injuries by an amount that exceeds the costs of the lawsuit).

19. *Cf.* Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073, 1085 (1984) (arguing that a judge's "job is not to maximize the ends of private parties, nor simply to secure the peace, but to explicate and give force to the values embodied in authoritative texts such as the Constitution and statutes: to interpret those values and to bring reality into accord with them").

20. Whether a legal system wishes to discourage certain forms of cost-effective litigation and whether it wishes to permit certain forms of cost-ineffective litigation are political choices that do not affect the general point. Even when a society encourages cost-prohibitive litigation for historical or political reasons, it is better that the litigation is conducted as efficiently as possible.

on litigation as long as it yields a net private gain—even though other parties and the court must now respond with expenditures that create a net social loss. Present and proposed reforms to pleading, discovery, and pretrial do little to address this fundamental problem.

1. The Problem

Because many litigants consider only the benefits they garner and the costs they incur, they consider neither the benefits of the lawsuit that they do not capture nor the costs that their behavior imposes on others.[21] In the first instance, when they fail to capture the benefits of litigation, they may choose not to bring or defend a socially valuable suit.[22] In the second instance, when litigants fail to regard the costs that their actions impose on others, they may bring or defend a suit that is socially costly. If the plaintiff stands to gain an expected $10,000 at an expected cost of $7,000, the plaintiff will file suit even if the lawsuit requires the defendant and the court also to spend $7,000 apiece. The fact that the case has a negative value (–$11,000) from society's viewpoint does not affect the plaintiff's decision to bring suit because the plaintiff does not bear the defendant's and court's costs.[23] Although private and social incentives to litigate may align (as they would if the costs to both parties and the court were $3,000 apiece, and the benefit was $10,000), in some cases they do not.

This hypothetical is a simplified example of the net-benefit calculations in which parties actually engage. As Professors Grundfest and Huang have shown, the parties invest in litigation in increments rather than all at once[24]—a fact that gives plaintiffs a surprising

21. Shavell, *supra* note 18, at 577–78.

22. *Id.* at 583–84. Creating incentives to engage in privately uneconomical but socially beneficial litigation is beyond the scope of this Article.

23. This hypothetical, which assumes that the expected $10,000 recovery is not only a social benefit but also the only social benefit, involves a self-regarding plaintiff. The party making a privately profitable but socially suboptimal litigation decision could also be a defendant. For instance, a defendant rationally would choose to invest $5,000 in litigation expenses that could be expected to reduce the claim by $6,000—even if the plaintiff and the court will expend an additional $7,000 apiece in responding to the defendant's investment.

24. *See* Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 STAN. L. REV. 1267, 1293–98 (2006) (adapting real-option theory used in determining whether to invest in a research-and-development project to the decision whether to invest in litigation). Real-option analysis differs from traditional economic analysis, which determines expected value by discounting the full value of a desired benefit by a constant discount rate that reflects the risk of not obtaining that benefit. Real-options analysis recognizes that risk levels can fluctuate as market conditions change and parties adapt to those changes. "While the traditional . . . approaches assume a fixed commitment to full investment at the outset, real option theory models the investment process as a series of decision points at which investors have the option of adjusting their investments in response to new information." *Id.* at 1273–74. At these

incentive under some conditions to file suit in cases in which neither they nor society expect a positive return.[25] For instance, if the plaintiff seeking to recover on a claim with an expected value of $10,000 must spend $14,000 in litigation expenses, it seems that the plaintiff will choose not to bring suit. In some cases, however, the plaintiff will do so because the plaintiff can abandon the suit without incurring all $14,000 in expenses. Suppose, for instance, that the plaintiff's claim, if successful, is worth $40,000 (but $0 if unsuccessful). The plaintiff's outlay for investigating and filing the complaint, and then responding to a motion to dismiss the case,[26] is $7,000, and the likelihood of surviving the pleading stage is fifty percent. If the case survives the first stage, the plaintiff must now invest an additional $7,000, with the two outcomes ($40,000 and $0) being equally likely. Overall, the plaintiff has a twenty-five percent chance of winning the case, so the claim has an expected value of $10,000.[27] In deciding whether to commence the case, however, the plaintiff knows that she does not need to commit all $14,000 at once. Instead, she can spend $7,000 in pursuit of an asset valued at $10,000—a sensible economic proposition. If she succeeds at the first stage, she now has a fifty-fifty chance to win $40,000, so an expenditure of another $7,000 is also rational.[28]

This result does not pertain across all situations; there are points at which a plaintiff has no incentive to bring a negative-value suit.[29] A decision to invest in negative-value litigation is most likely to

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decision points an investor can continue to invest or to withdraw funding, depending on the perceived risk of doing so at that moment. As Professors Grundfest and Huang show, this approach has great salience in litigation; because parties do not invest money all at once but rather incrementally over the course of the lawsuit, they can adjust their decisions about how much to invest in the next step of the litigation process based on how well (or poorly) the litigation has gone so far.

25. *Id.* at 1277, 1299–305 (explaining that a lawsuit with a negative expected value is equivalent to an out-of-the-money call option that a plaintiff will rationally pursue as long as the price of the option is low and the volatility of the claim's value is high).

26. *See* FED. R. CIV. P. 12(b) (describing seven grounds on which a court may dismiss a complaint).

27. I assume that the expenses for the defendant and the court for each stage are also $7,000 apiece, although (because the plaintiff does not bear these costs) their exact amount does not bear on the plaintiff's calculations. Throughout these examples I also assume the rationality and risk neutrality of both parties.

28. By "rational" I mean that the plaintiff seeks to maximize her wealth at each stage of the litigation process. *See* Grundfest & Huang, *supra* note 24, at 1275 (specifying that, in a real-options model for litigation, the litigants are "identical, risk-neutral, individually rational agents who share common knowledge about all of a lawsuit's characteristics"). Thus, the plaintiff spends the first $7,000 to pursue an asset worth, at that time, $10,000; she spends another $7,000 (or $14,000 in total) only when new information (success at the pleading stage) suggests a new value ($20,000) for the claim.

29. Grundfest & Huang, *supra* note 24, at 1282, 1302–04.

occur when the variance in the value of the claim (in the sense that the value can change significantly as it clears each stage) is great.[30] The most important point about this analysis, however, is that it does not alter—indeed, it fundamentally confirms and expands the application of—the principle that private parties' litigation incentives sometimes diverge from the social ideal, resulting in the maintenance of socially wasteful litigation.[31]

The prior hypotheticals assumed that the only benefit of litigation is the recovery provided in the judgment or settlement. In some cases, however, litigation yields other private benefits, not all of them legitimate from society's viewpoint. Perhaps a lawsuit scares off potential competitors[32] or allows a public-interest organization to influence policy or generate contributions.[33] Despite the social costs involved, its private benefits can provide an incentive to litigate.

Although each rule affects the circumstances under which parties will engage in privately beneficial but socially wasteful litigation, neither the American nor the English rule for payment of attorney's fees eliminates the incentive to do so.[34] To illustrate, take the prior negative-value hypothetical, in which the plaintiff will rationally choose to invest $7,000 initially and another $7,000 should she survive the motion to dismiss, in a $40,000 case with a fifty-fifty chance of prevailing at each stage. Assume further that the defendant can be expected to spend $5,000 in defending the first stage (through the motion to dismiss) and $10,000 in the second stage (from pretrial through trial).[35] Costs to the court through the motion-to-dismiss stage

30. *Id.* at 1277. The traditional present-value approach used to calculate whether (and to what extent) the parties will file and defend suits, *see supra* text following note 22, is simply a special case of this real-option analysis—a case in which the value of the claim varies little as the parties develop new information. *Id.* at 1295.

31. *Id.* at 1320 ("[U]ncertainty alone can be sufficient to throw a monkey wrench into the proposition that private litigation can systematically be relied upon to achieve optimal social objectives even in a risk-neutral world.").

32. *Cf.* Glaxo Wellcome, Inc. v. Pharmadyne Corp., 32 F. Supp. 2d 265, 272 (D. Md. 1998) (noting that the plaintiff "had publicly stated its policy to use patent infringement litigation to prevent generic competitors from marketing [competing] products").

33. *Cf.* Amnesty Int'l USA v. Clapper, 667 F.3d 163, 203 (2d Cir. 2011) (Jacobs, J., dissenting from the denial of rehearing in banc) ("[T]he only purpose of this litigation is for counsel and their plaintiffs to act out their fantasy of persecution, to validate their pretensions to policy expertise, to make themselves consequential rather than marginal, and to raise funds for self-sustaining litigation.").

34. *See* Grundfest & Huang, *supra* note 24, at 1325–26 (briefly discussing the relevance of real-option analysis in determining the better fee-shifting rule).

35. This disparity between plaintiff and defendant might seem anomalous, but defense expenditures often exceed those of the plaintiff. *See* JAMES A. KAKALIK & NICHOLAS M. PACE, RAND, THE INST. FOR CIVIL JUSTICE, COSTS AND COMPENSATION PAID IN TORT LITIGATION vii–viii

are an expected $2,000, with another $4,000 in expected costs for the second stage. Thus, total costs through the first stage of litigation are $14,000 ($7,000 plaintiff + $5,000 defendant + $2,000 judicial) for a case with an expected value at that point of $10,000. Total costs for the second stage of the litigation are $21,000 ($7,000 plaintiff + $10,000 defendant + $4,000 judicial) for a case with an expected value at that point of $20,000.[36] Unless the lawsuit yields other benefits that exceed the net loss,[37] society would prefer that the case not be filed.

Under either the American or the English rule, however, the case will be filed. Under the American rule, the plaintiff has an incentive to file suit for the reason that I have explained. The plaintiff does not bear the costs of the defense or the court. Because her own costs are less that her expected recovery at both the first and the second stages of the suit, she will file suit and continue to prosecute it if she clears the motion-to-dismiss hurdle.

Under the English rule, the plaintiff will bear both parties' costs if she loses but neither party's costs if she wins; like the American rule, however, she does not pay the costs of the court, so she can ignore them. At the first stage of the litigation, the total costs of the parties are $12,000. The plaintiff has a fifty percent chance of immediately paying these costs. Because her risk of paying first-stage costs ($6,000) is less than her present expected recovery ($10,000), she will file suit.[38] At the

(1986) (reporting that defense litigation expenditures in tort cases were $8 to $10 billion, and plaintiffs' expenditures were $6 to $8 billion).

36. Although stylized to demonstrate the problem, the numbers used in the example are hardly outlandish. One study found that it cost fifty-four cents to deliver forty-six cents of compensation to tort victims. *Id.* at iii. In asbestos cases, that figure rose to sixty-three cents to deliver thirty-seven cents of compensation. JAMES A. KAKALIK ET AL., RAND, THE INST. FOR CIVIL JUSTICE, COSTS OF ASBESTOS LITIGATION 40 (1983); *see also* A. Mitchell Polinsky & Steven Shavell, *The Uneasy Case for Product Liability*, 123 HARV. L. REV. 1437, 1469–70 (2010) (reviewing data suggesting that in tort cases roughly one dollar in litigation expenses is incurred for every dollar received by plaintiffs). Although these data often do not factor in the deterrence benefits of these suits, the costs to the judicial system to resolve the cases, the costs of administering insurance payments, or the costs associated with discouraging lawful behavior, they provide some support for the insight that private incentives to litigate under the American rule can, in some cases, cause parties to engage in litigation in which social costs exceed social benefits. For a general discussion, see Shavell, *supra* note 18, at 581–86.

37. *Cf.* Shavell, *supra* note 18, at 582–83 (discussing situations in which a lawsuit creates no deterrence benefit). Professor Shavell would go farther and argues that compensation paid to a victim is not generally a social benefit. *Id.* at 594–95. On this view, deterrence and other benefits, net of costs such as the deterrence of socially useful behavior, must be even greater to justify the lawsuit.

38. The plaintiff also has a chance of paying these costs if she loses at the second stage. I account for this possibility in the text following this note, but another way that the plaintiff might consider the issue is to recognize that there is, overall, a seventy-five percent chance that she will pay $12,000 in first-stage costs (or $9,000). Because her expected recovery of $10,000 is still greater, she will file suit.

second stage, the total costs to the parties are $17,000, which the plaintiff has a fifty percent chance of paying, for an expected cost of $8,500. In addition, she still has a fifty percent chance of paying the $12,000 in first-stage costs, or $6,000. Added together, the plaintiff's expected second-stage costs are $14,500, less than the $20,000 expected recovery at the second stage. Hence, the plaintiff will file suit if costs are distributed under the English rule.

Of course, the incentives are not identical under the two systems.[39] Generally speaking, as the risk of losing and the amount of the defense expenditures rise, the English rule creates a greater disincentive for plaintiffs to file suit. For instance, if the defendant were to spend $8,000 in first-stage litigation costs and the plaintiff's chance of moving past that stage were forty percent, the case would no longer be worth filing under the English rule, although it would remain a viable proposition under the American rule.[40] On the other hand, as a general matter the English rule creates a greater incentive for plaintiffs to file suit and spend money on the litigation as the likelihood of the plaintiff's success rises. When the plaintiff is very likely to recover her costs, she has a limited incentive to keep them under control.[41] For instance, if the chance that the plaintiff will navigate each stage successfully rises to seventy-five percent and if the defendant's costs of defense remain constant, then the plaintiff has an incentive to spend as much as an extravagant $84,999 at the first stage of the litigation and another $20,000 at the second stage.[42] In cases in which the plaintiff

39. *See generally* Barbara Luppi & Francesco Parisi, *Litigation and Legal Evolution: Does Procedure Matter?*, 152 PUB. CHOICE 181, 182–83 (2012) (creating an economic model to analyze the American-rule and English-rule incentives to litigate under varying conditions of uncertainty over the outcome).

40. With the reduction of the first-stage risk to forty percent, the value of the claim at the first stage falls to an expected $8,000. Under the American rule, the plaintiff's expenditure of $7,000 in first-stage claims remains less than the expected value of the case, so the plaintiff will file suit. Under the English rule, however, the plaintiff bears a sixty percent risk of paying $15,000 in costs (an expected $9,000), making the claim no longer worth filing.

41. The converse is true when the plaintiff has a weak claim: the defendant then has a limited incentive to keep his costs under control.

42. At the first stage, the expected recovery is $22,500 ($40,000 discounted by a twenty-five percent chance of losing the first stage and another twenty-five percent chance of losing the second stage). At the first stage, therefore, the plaintiff has an incentive to spend as much as $22,499 on the case. Given that the defendant's expenditure is $5,000 and the plaintiff bears only a twenty-five percent chance of bearing both that cost as well as her own, she can spend $84,999 on the first stage and still be money ahead ($22,500 > .25 × ($84,999 + $5,000)). At the second stage, she now has a seventy-five percent chance of winning $40,000. Given that the defendant's expenditures at the second stage are $10,000 and that the plaintiff bears a twenty-five percent chance of losing the second stage, the plaintiff has a twenty-five percent chance of paying the defendant's expenditures of $15,000 plus her own. If she expended the maximum $84,999 at the first stage, she can still spend another $20,000 at the second stage (.75 × $40,000 > .25 × ($15,000 + $84,999 + $20,000)).

has a strong claim, the English rule provides incentives to pursue socially wasteful litigation that are more perverse than the American rule.[43]

Until now, I have assumed that each party acts with indifference to the costs that its litigation conduct imposes on other parties. In some cases, however, parties may engage in socially wasteful litigation practices precisely to impose costs. Four scenarios are most common. In the first, a particular case may be similar to other cases, and the defendant spends a vast amount of money on the case—spending, say, $1 million on a case worth $500,000—to discourage later litigants from filing suit. This type of "scorched earth" tactic can be entirely rational from the defendant's standpoint if it discourages potential plaintiffs from bringing similar claims in the future.[44]

In the second scenario, one party engages in litigation tactics designed to create leverage. Assume that the plaintiff's expected recovery is $10,000 and the costs to the plaintiff, the defendant, and the court of resolving the case are $7,000 apiece. Under the American rule, before expenses are incurred, the case should settle for something between $3,000 and $17,000,[45] with a midpoint of $10,000. Now suppose that the plaintiff is entitled to discover relevant information that would add no value to the case but would cost the defendant $8,000 to provide. The plaintiff might rationally request this discovery and then seek to settle the case for a higher figure than she could have obtained before. Because the defendant's cost of litigation has now risen to $25,000, the plaintiff has pushed up the midpoint settlement up to $14,000. This type of "impositional discovery," in which either a plaintiff seeks to extort a higher settlement or a defendant seeks to extort a lower

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If the plaintiff spends less than $84,999 on the first stage, she can spend more on the second stage, as long as the amounts spent on both stages is less than $105,000.

43. *Cf.* Shavell, *supra* note 18, at 587–88 (noting that "fee-shifting would tend to worsen any problem of excessive suit").

44. This tactic has sometimes been associated with tobacco companies engaged in product-liability litigation. *See* Robert L. Rabin, *A Sociolegal History of the Tobacco Tort Litigation*, 44 STAN. L. REV. 853, 857–58 (1992) (describing the tobacco companies' "no-compromise strategy," in which "they would, as a first line of defense, spare no cost in exhausting their adversaries' resources short of the courthouse door," as a reaction to "the size of the . . . financial stakes" if they began to settle claims). The difference in investment incentives between the sole plaintiff and the repeat-player defendant is an argument for aggregating related claims into one suit, thus equalizing incentives of plaintiffs and defendants. *See* David Rosenberg, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 HARV. L. REV. 831, 852–53 (2002). I assume that this aggregation has not occurred.

45. The plaintiff will not consider any offer less than $3,000 because she can expect a net recovery of $3,000 ($10,000 expected gross recovery less $7,000 in expected costs). The defendant will not make an offer greater than $17,000 because the most it expects to pay after trial is a $10,000 judgment plus $7,000 in costs.

settlement (or dismissal), is a classic form of discovery abuse.[46] It is not clear how often impositional discovery actually occurs,[47] but in theory parties might rationally act in this manner. Whatever its prevalence, impositional discovery remains a bogeyman of civil procedure; a number of recent reforms have been designed to stamp it out.[48]

Two other scenarios are the converse of impositional discovery: they are impositional responses to discovery. First, a party may "stonewall," refusing to provide information responsive to legitimate discovery requests.[49] The nonresponding party hopes that the cost to the requesting party of obtaining the information is so great that the requesting party will either abandon the request or cut it back. Being obstreperous is costly, but it is a worthwhile strategy if the value of the information shielded from discovery would have altered the value of the claim by more than the cost of stonewalling.[50]

Another impositional response strategy is the "document dump."[51] Under this approach, a responding party buries the requesting

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46. *See* Frank H. Easterbrook, *Discovery as Abuse*, 69 B.U. L. REV. 635, 638 (1989) ("[I]mpositional requests may inflict on the responding party costs substantially greater than the social value of the information."); John K. Setear, *The Barrister and the Bomb: The Dynamics of Cooperation, Nuclear Deterrence, and Discovery Abuse*, 69 B.U. L. REV. 569, 582 (1989) (" 'Impositional benefits' . . are those benefits that the requesting party expects to gain because her request imposes costs upon the answering party.").

47. *See* Jack B. Weinstein, *What Discovery Abuse? A Comment on John Setear's* The Barrister and the Bomb, 69 B.U. L. REV. 649, 649–51 (1989) (describing five forms of discovery abuse and suggesting that impositional discovery is "the least important"; further noting the views of several magistrate judges that impositional discovery abuse is "not an appreciable problem" and is "rare").

48. *See* FED. R. CIV. P. 26 advisory committee's note (1983 Amendment) (stating that the new proportionality rule should be used "in an even-handed manner that will prevent use of discovery to wage a war of attrition or as a device to coerce a party, whether financially weak or affluent"); FED. R. CIV. P. 30 advisory committee's note (2000 Amendment) (noting that time limits on depositions were necessary because "overlong depositions can result in undue costs and delays"); Memorandum, *supra* note 2, at 3–4 (stating that the proposed reforms to the Federal Rules of Civil Procedure are "a package of integrated measures that would work toward [the] goals" of "cooperation, proportionality, and active case management").

49. *See*, *e.g.*, MAZ Partners v. PHC, Inc. (*In re* PHC, Inc. S'holder Litig.), 762 F.3d 138, 145 (1st Cir. 2014) (declining to permit entry of summary judgment until the plaintiff had a fair opportunity to obtain discovery; "[t]o rule otherwise would encourage defendants to 'stonewall' during discovery—withholding or covering up key information that is otherwise available to them through the exercise of reasonable diligence" (internal quotation marks omitted)).

50. *See* ADVISORY COMM. ON CIVIL RULES & COMM. ON RULES OF PRACTICE & PROCEDURE, JUDICIAL CONFERENCE OF THE U.S., REPORT TO THE CHIEF JUSTICE OF THE UNITED STATES ON THE 2010 CONFERENCE ON CIVIL LITIGATION 7 (2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/2010%20report.pdf, *archived at* http://perma.cc/2625-CQP4 ("[P]laintiff-side lawyers reported practices such as 'stonewalling' . . . accompanied by long delays, overly narrow interpretations of discovery requests, and motions that require expensive responses from opposing parties and that create delay while the court rules.").

51. *See* A&M Records, Inc. v. Lamonte, 366 F. App'x 736, 738–739 (9th Cir. 2010) (upholding sanction of contempt when a defendant ultimately produced "an unorganized 'document dump' "

party in a blizzard of information that is costly to process and digest. Dumping creates some costs for the responding party, but if dumping swamps the requesting party and forces that party to expend its limited resources on sorting through largely irrelevant material (rather than on conducting other discovery that might be detrimental to the responding party), the strategy can be worthwhile.

2. The Ineffectiveness of Reforms in Addressing the Problem

Despite their intention to the contrary, recent and proposed reforms to pleading, discovery, and pretrial do little to alter privately rational but socially undesirable incentives to litigate. Raising the pleading bar, as the Supreme Court has done,[52] has two effects. First, it screens out cases in which the plaintiff's limited access to information makes it impossible for the plaintiff to meet the plausibility standard, resulting in either dismissal of a filed claim or a decision to forgo filing a claim.[53] Second, it increases the cost of the pleading process in cases in which the plaintiff has access to sufficient information. In the second situation, the additional cost may induce plaintiffs whose cases already hover near the break-even point not to sue, but this cost likely has an impact on only a few cases at the margin.

In neither instance is heightened pleading targeted toward cases in which the parties have an incentive to expend a socially excessive

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of mostly irrelevant material); Dana A. Remus, *The Uncertain Promise of Predictive Coding*, 99 IOWA L. REV. 1691, 1693 (2014) ("Litigants began 'document dumping'—flooding opponents with unmanageable datasets to increase costs and decrease their chances of finding key documents.").

52. *See supra* notes 5–7 and accompanying text. The Court has not retreated from this standard. *See* Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459, 2471 (2014) (suggesting that, in light of the fiduciaries' legal obligations, plaintiff employees may have difficulty pleading plausible claims against the fiduciaries of an employee stock ownership plan who continued to invest in the company despite the allegedly overvalued price of its stock; remanding to the court of appeals to apply the "prudent person" standard); Wood v. Moss, 134 S. Ct. 2056, 2065 n.5 (2014) (reiterating *Iqbal*'s instruction that "courts 'must take all of the factual allegations in the complaint as true,' but 'are not bound to accept as true a legal conclusion couched as a factual allegation' " in a case involving the qualified immunity of Secret Service agents (citing Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009))); Lexmark Int'l, Inc. v. Static Control Components, Inc., 134 S. Ct. 1377, 1391 n.6 (2014) (stating that, "like any other element of a cause of action, [proximate cause] must be adequately alleged at the pleading stage in order for the case to proceed" (citing *Iqbal*, 556 U.S. at 678–79)). The pending amendments to the Federal Rules of Civil Procedure also propose to abrogate Rule 84 and the official forms promulgated under it. *See* Memorandum, *supra* note 2, at 2. Given the tension between the minimalist forms and the new pleading standard, *see* Bell Atl. Corp. v. Twombly, 550 U.S. 544, 575–76 (2007) (Stevens, J., dissenting), this abrogation can be viewed as part of the effort to require more detailed pleadings.

53. *See* Jonah B. Gelbach, Note, *Locking the Doors to Discovery? Assessing the Effects of* Twombly *and* Iqbal *on Access to Discovery*, 121 YALE L.J. 2270, 2331–32 (2012) (using an economic model to estimate that *Twombly* and *Iqbal* have had, at a minimum, a negative effect in fifteen percent to twenty-one percent of cases).

amount of money on litigation. Heightened pleading may screen out some cases in which parties have such an incentive, but it may also screen out cases that are socially desirable to litigate. Likewise, in cases in which plaintiffs are willing to incur the greater pleading expense and still file suit, raising the pleading bar is only worth the additional cost of pleading if it reduces subsequent litigation expenses by more than the cost of pleading—for instance, by reducing the number of unsuccessful motions to dismiss that courts must decide or by clarifying the scope of discovery—but not otherwise.

Indeed, real-option analysis shows that increasing the pleading bar may sometimes induce parties to file negative-value suits that they would not have filed with a lower pleading bar. Consider a case in which there are only two stages: a pleading stage and pretrial-and-trial stage. The full value of the plaintiff's claim is $26,000. Should the case reach the pretrial-and-trial stage, the chances of recovery are fifty percent. Further assume that no pleading bar exists,[54] that the plaintiff's expected costs are $7,000 for the pleading stage and $7,000 for the pretrial-and-trial stage, that the defendant's costs are the same, and that the court's costs are $1,000 for both stages combined. Because the plaintiff has an expected recovery of $13,000 and expected costs of $14,000, the plaintiff will not file suit under either the American or the English rule. This result matches up with society's desired outcome. Assuming no other social benefits or costs from the litigation had the lawsuit proceeded, it would have cost $29,000 to redeem a $26,000 asset.

On the other hand, assume that the pleading stage contains a motion to dismiss, on which the plaintiff stands an eighty percent chance of prevailing. If she clears this hurdle, she then stands a sixty percent chance of prevailing at trial.[55] Because of the extra costs of the motion, the plaintiff and the defendant can both expect to spend $9,000 at the pleading stage, and the court will spend an extra $1,000 to resolve the motion; pretrial-and-trial costs for the parties and the court remain constant. Under the American rule the plaintiff will invest $9,000 in initial pleading-stage costs because the value of the claim at this point is $12,480 ($26,000 × .8 × .6). If she clears the motion-to-

54. Without a pleading bar, the plaintiff has a one hundred percent chance of reaching the pretrial-and-trial stage. Therefore, the parties and the court will incur all of the expenses during both the pleading stage and the pretrial-and-trial stage.

55. For instance, the case may involve both a legal question and a factual question. The legal question is one that could be answered on a motion to dismiss, and the existing precedents on the issue strongly favor the plaintiff, giving her an eighty percent chance of prevailing on the motion. After clearing this hurdle, the plaintiff must still prove the case, and the facts, while generally favoring the plaintiff, give her a sixty percent chance of success at trial.

dismiss hurdle, she will then spend the next $7,000 in pretrial-and-trial costs because her expected recovery at that point is $15,600 ($26,000 × .6).[56] From a social viewpoint, however, the case—with a potential recovery of $26,000 at a cost to the parties and court of $34,000[57]—should not be filed.

By creating a first-stage hurdle that allows a plaintiff to forgo some litigation expenses if the case is unsuccessful, heightened pleading can counterintuitively induce more litigation. Whether it does so in a particular case depends on the odds of prevailing and the expected costs and recovery of that case. To the extent that the goal is to reduce socially wasteful litigation, however, raising the pleading bar is not an unadulterated solution.

The same difficulty infects most of the other procedural reforms. In particular, reforms designed to limit the scope of discovery or the frequency with which discovery devices can be used[58] do not limit the amount of money that parties can spend on litigation. All they may do is funnel the parties' expenditures into the remaining permissible channels of discovery.

For instance, one of the present reform proposals eliminates the capacity of parties to obtain information relevant to the "subject matter" of the case, instead limiting parties to the discovery of information relevant to existing claims and defenses.[59] It is not clear how much "subject matter" discovery occurs or how much its elimination will save. In any event, this proposal is unlikely to have much effect on reducing the cost of litigation. One reason is the discovering party's ability to characterize a request that sits on the borderline between "claim or defense" and "subject matter" discovery as the former.[60] A more substantial reason is that parties denied one avenue of discovery may invest their money in other discovery or litigation expenditures. Assume that it makes sense for a party to limit discovery expenditures to $20,000. The cost to obtain essential discovery is $18,000, leaving

56. The plaintiff would also file suit under the English rule. In deciding whether to file suit, she would realize that, if she cleared the first stage, she would have a sixty percent chance of recovering $26,000 (or $15,600), compared to a forty percent chance of paying the parties' combined $32,000 in costs (or $12,800).

57. The parties will expend $16,000 apiece (or $32,000 in total), and the court $2,000.

58. *See supra* notes 2, 8, and accompanying text.

59. *Compare* FED. R. CIV. P. 26(b)(1) (permitting a court to order "subject matter" discovery on a showing of "good cause"), *with* Memorandum, *supra* note 2, at 20 (recommending the elimination of "subject matter" discovery).

60. *Cf. In re* Cooper Tire & Rubber Co., 568 F.3d 1180, 1190–93 (10th Cir. 2009) (denying a writ of mandamus to prevent discovery of the design and failure rates of tires similar to the tire involved in the lawsuit because the discovery was relevant to the plaintiffs' "broad theory" of liability and was therefore not "subject matter" discovery).

another $2,000 to invest at its discretion. If a $2,000 investment in subject matter discovery would yield an expected $4,000 change in the value of the case, the party will invest in that discovery as long as no other litigation (or other) investment promises a greater return. But if subject matter discovery is curtailed, the party will not necessarily put that $2,000 back in its pocket. The party will look to see if there are other litigation expenditures that will change the value of the case by more than the party could make by investing the $2,000 on nonlitigation items. Perhaps a $2,000 investment in a better expert or a better lawyer will yield an expected gain of $3,500, or perhaps additional legal research will result in an expected increase of $3,000. In short, curtailing "subject matter" discovery does not guarantee a reduction in the overall amount that parties spend on litigation. It is most likely to have an effect in cases involving scorched-earth tactics or impositional discovery, for the simple reason that it limits the subjects of inquiry that proponents of these tactics can pursue. But, even here, the party bent on imposing costs on an opponent can often channel the money that would have gone into subject-matter discovery into other forms of case-relevant discovery, or into more experts or lawyers.

The same is true of other reforms that curtail discovery. For example, limiting the parties' resort to discovery devices such as depositions or interrogatories—limitations implemented in prior waves of discovery reform[61]—will shift discovery expenses away from these techniques but cannot guarantee that the parties' overall litigation expenses will be less.

In addition, limiting investment options in litigation may rob society of some of the value of the litigation. A party will not invest $2,000 in subject-matter discovery unless that expenditure can be expected to yield more benefit than other possible expenditures. If we assume that this benefit is a change in case value of $4,000, and if the next-best expenditure yields a change in case value of $3,500, then society has lost $500 by denying subject-matter discovery.[62]

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61. *See* FED. R. CIV. P. 30(a)(2)(A)(i) (limiting the number of depositions to ten per side), FED. R. CIV. P. 30(d)(1) (limiting the duration of a deposition to one day of seven hours), FED. R. CIV. P. 33(a)(1) (limiting the number of interrogatories to twenty-five). A proposal to further limit resort to certain discovery devices did not make the final cut of the pending amendments to the Federal Rules of Civil Procedure. *See supra* note 2.

62. I assume that the costs to the other party and the court of responding to this "subject matter" discovery, after considering the costs of responding to the next-best discovery tactic, are less than $500. If not, then precluding the "subject matter" discovery is appropriate. In addition, real-option analysis shows that increasing the variance in claim value (which a potential $4,000 change in claim value does more than a potential $3,500 change in claim value) also increases the willingness of parties to litigate low-value claims—a result that may be socially undesirable. Likewise, "subject matter" discovery might be properly objectionable because it is used only to

In a similar way, case-management techniques, which have continued to expand since their deployment in 1983, can have only a modest effect on the parties' litigation incentives.[63] For the most part, the judge's case-management tools allow a judge to restrict discovery either directly (by limiting the amount or subjects of discovery)[64] or indirectly (by imposing deadlines that make extended discovery impossible or attempting to get the parties to abandon or stipulate to certain issues).[65] We have seen the problem of direct methods.[66] With respect to indirect means, powers such as the ability to streamline the case by striking out issues in theory could rein in socially excessive spending on litigation. In reality, however, a judge cannot prevent the parties from channeling their resources into remaining claims and defenses. More important, the managerial judge has no roving authority to strike issues from a case. The judge can do so only if a claim or defense fails to meet the stringent legal standards for Rule 12 motions to dismiss[67] or Rule 56 motions for summary judgment.[68] As we have seen, the pleading standard does not necessarily reduce costs.[69] Moreover, motions for summary judgment, which usually occur "after adequate time for discovery,"[70] cannot avoid many litigation costs either.

The case-management power that might have the greatest effect in heading off unnecessary expense—the judge's ability to urge the use

impose costs on another party, a subject considered *supra* notes 45–48 and accompanying text. A flat rule barring "subject matter" discovery fails to capture these fine-grained decisions about case value, costs, and party behavior.

63. Developed principally as an ad hoc response to the problem of complex litigation, *see* Judith Resnik, *Managerial Judges*, 96 HARV. L. REV. 374, 377–78 (1982), case management moved into the mainstream of American litigation with the substantial reconstruction of Rule 16 in 1983 and its further expansion in 1993, 2000, and 2006. *See* FED. R. CIV. P. 16 advisory committee's note (1983 Amendment) ("The amended rule makes scheduling and case management an express goal of pretrial procedure."); Steven S. Gensler, *Judicial Case Management: Caught in the Crossfire*, 60 DUKE L.J. 669, 674–84 (2010) (chronicling the growth of case management in the Federal Rules).

64. *See* FED. R. CIV. P. 16(c)(2)(F), (O); *see also* FED. R. CIV. P. 16 advisory committee's note (1993 Amendment) ("[A] major objective of pretrial conferences should be to consider appropriate controls on the extent and timing of discovery.").

65. *See* FED. R. CIV. P. 16(b)(3)(A), (c)(2)(A)–(E).

66. *See supra* notes 58–61 and accompanying text.

67. *See supra* notes 5–7 and accompanying text.

68. *See* FED. R. CIV. P. 56(a) (authorizing summary judgment when "there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law"); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986) (linking this standard to Rule 50(a)'s "reasonable jury" standard for granting judgment as a matter of law). *See generally* JAY TIDMARSH & ROGER H. TRANGSRUD, MODERN COMPLEX LITIGATION 848–64 (2d ed. 2010) (describing the authorities under which judges can adjudicate factual disputes).

69. *See supra* notes 52–57 and accompanying text.

70. Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986).

of alternative dispute resolution ("ADR") techniques or to facilitate settlement[71]—is weak: the court cannot force parties either to make or to accept a settlement offer, its power to force participation in ADR methods has limits, and it cannot force a party to accept the outcome of nonbinding ADR.[72] In any event, the data on the use of ADR are not encouraging. ADR turns out to be a wash, saving time and money when it works but costing time and money when it does not.[73] The same verdict applies to nearly all case-management methods: with a couple of exceptions, case management reduces costs in some cases and increases them in others, with the net effect on costs being negligible.[74]

Therefore, in many cases, recent and proposed reforms in pleading, discovery, and pretrial will not have their intended effect of reducing costs. In some cases, they may have the opposite effect of spurring socially wasteful litigation practices.

The one exception is the requirement of proportionality. The principle that discovery be proportional to the needs of a case was introduced as a one-sentence amendment to Rule 26(b)(1) in 1983.[75] Proportionality has had a peripatetic existence ever since, moving into the newly created Rule 26(b)(2) in 1993,[76] splitting itself between Rule

71. *See* FED. R. CIV. P. 16(c)(2)(I) (authorizing a court to take measures regarding "settling the case and using special procedures to assist in resolving the dispute when authorized by statute or local rule").

72. *See*, *e.g.*, Strandell v. Jackson Cnty., Ill., 838 F.2d 884, 888 (7th Cir. 1987) (holding that a district court does not possess inherent power to compel participation in a mandatory summary jury trial); *In re* Selby, 481 B.R. 90, 104 (Bankr. E.D. Okla. 2012) ("The Court cannot force a party to accept a settlement offer it does not wish to accept, nor to make counteroffers."). *But see* FED. R. CIV. P. 16 advisory committee's note (1993 Amendment) (stating that statutes and local rules may provide the authority to use "alternative procedures such as mini-trials, summary jury trials, mediation, neutral evaluation, and nonbinding arbitration"; further noting that the present Rule 16(c)(2)(I) "does not attempt to resolve questions as to the extent a court would be authorized to require such proceedings as an exercise of its inherent powers").

73. *See* JAMES S. KAKALIK ET AL., RAND, THE INST. FOR CIVIL JUSTICE, AN EVALUATION OF JUDICIAL CASE MANAGEMENT UNDER THE CIVIL JUSTICE REFORM ACT 71–76 (1996); JAMES S. KAKALIK ET AL., RAND, THE INST. FOR CIVIL JUSTICE, AN EVALUATION OF MEDIATION AND EARLY NEUTRAL EVALUATION UNDER THE CIVIL JUSTICE REFORM ACT 52–53, 63–65 (1996) [hereinafter KAKALIK ET AL., MEDIATION].

74. *See* KAKALIK ET AL., MEDIATION, *supra* note 73, at xxx–xxxv (reporting data that savings from the successful use of ADR in some cases were evenly balanced against the cost and delay from the unsuccessful use of ADR in other cases); *id.* at xxx (describing similar inconclusive results in prior investigations of court-annexed arbitration programs).

75. *See* FED. R. CIV. P. 26(b)(1) (1983) (limiting discovery when it is cumulative or duplicative, when a party had ample prior opportunity to discover the information, or when "the discovery is unduly burdensome or expensive, taking into account the needs of the case, the amount in controversy, limitations on the parties' resources, and the importance of the issues at stake in the litigation").

76. *See* FED. R. CIV. P. 26(b)(2) (1993).

26(b)(1) and Rule 26(b)(2) in 2000,[77] and then expanding into the newly drafted e-discovery amendment of Rule 26(b)(2)(B) in 2006.[78] The pending reforms to the Federal Rules of Civil Procedure move proportionality back up to Rule 26(b)(1) and give it more emphasis.[79] These changes in location reflect proportionality's increasingly central role in civil litigation and have been designed to ensure that judges and parties pay the principle adequate heed.[80] The principle itself has remained constant from the outset.

Ensuring that litigation activities are worth their price is precisely the right way to prevent socially wasteful spending. That said, Rule 26 proportionality has drawbacks. First, despite the efforts of rulemakers to emphasize proportionality, parties and courts often have insufficient information to determine accurately whether a particular line of discovery is worth its cost; they are unlikely to know what the cost of the proposed discovery will be, how the evidence proposed to be discovered will affect the value of the case, or what other social benefits and costs flow from the plaintiff's success or failure.[81] Without a ready means of implementation, parties and courts sometimes fail to give proportionality its due.[82]

Second, Rule 26 proportionality is a conglomeration of factors. In deciding whether "the burden or expense of the proposed discovery outweighs its likely benefit," a court considers "the needs of the case, the amount in controversy, the parties' resources, the importance of the

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77. The proportionality rule remained in Rule 26(b)(2), but a sentence was added to Rule 26(b)(1) calling attention to it. *See* FED. R. CIV. P. 26(b)(1) (2000) ("All discovery is subject to the limitations imposed by Rule 26(b)(2)(i), (ii), and (iii).").

78. *See* FED. R. CIV. P. 26(b)(2)(B) (2006) and FED. R. CIV. P. 26 advisory committee's note ("The amendment to Rule 26(b)(2) is designed to address issues raised by difficulties in locating, retrieving, and providing discovery of some electronically stored information.").

79. The present draft of proposed Rule 26(b)(1) provides:

> Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense and proportional to the needs of the case, considering the importance of the issues at stake in the action, the amount in controversy, the parties' relative access to relevant information, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery outweighs its likely benefit.

Memorandum, *supra* note 2, at 20.

80. *See id.* at 4–8 ("The cost-benefit factors included in present Rule 26(b)(2)(C)(iii) are moved up to become part of the scope of discovery, identifying elements to be considered in determining whether requested discovery is proportional to the needs of the case.").

81. *See* 8 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 2008.1 (3d ed. 2010) (noting that "the proportionality concept . . . seemed to require great familiarity with the case," thus stymying its implementation to a degree).

82. *See*, *e.g.*, Thompson v. Dep't of Housing & Urban Dev., 199 F.R.D. 168, 171 (D. Md. 2001) (noting that, "[d]espite the obvious utility of the [proportionality] factors in tailoring discovery," they "have tended largely to be ignored by litigants, and, less frequently than desirable, used by the courts").

issues at stake in the action, and the importance of the discovery in resolving the issues."[83] No particular weight is given to any factor. Such open-ended, multi-factor tests breed uncertainty and are subject to manipulation.[84]

Third, the Rule 26 proportionality factors contain an ambiguity: whether the court should analyze the issue from the viewpoint of the litigants or from the viewpoint of society.[85] As we have seen, the two viewpoints are not the same.

Fourth, proportionality works better as a response to excessively costly discovery and pretrial activities—such as scorched-earth tactics or impositional discovery—than to excessively costly responses to discovery—such as stonewalling and document dumps. In theory the same principle of proportionality applies to discovery and discovery responses. But in reality it is difficult to enforce a principle that requires responding parties to provide neither too little information nor too much.

A final difficulty with the present proportionality principle is that it applies only to discovery, not to the full range of pleading and pretrial matters. Because discovery accounts for a substantial share of all litigation expenses—as much as half according to one estimate[86]—keeping discovery costs proportional is important. But there is no comparable means by which the court can keep the parties' decisions regarding pleading, motions, and other litigation conduct in balance.[87]

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83. FED. R. CIV. P. 26(b)(2)(C)(iii).

84. *Cf.* Tennessee v. Lane, 541 U.S. 509, 556 (2004) (Scalia, J., dissenting) (critiquing the Fourteenth Amendment's congruence-and-proportionality standard because "such malleable standards as 'proportionality,' . . . have a way of turning into vehicles for the implementation of individual judges' policy preferences").

85. The Advisory Committee that first adopted a proportionality rule believed that proportionality required consideration of the larger social benefits of litigation. *See* FED. R. CIV. P. 26 advisory committee's note (1983 Amendment) (noting that a court should consider "the significance of the substantive issues, as measured in philosophic, social, or institutional terms"; further noting that "many cases in public policy spheres, such as employment practices, free speech, and other matters, may have importance far beyond the monetary amount involved."). Courts received no direction, however, for applying proportionality when the private benefit of litigation exceeded its public benefit.

86. *See* Willging et al., *supra* note 10, at 531 (describing sample results in which, of the $13,000 spent on litigation expenses in the median case, "about half" went to discovery). *See also* Kakalik et al., *supra* note 10, at 637 (estimating that an average of thirty-six percent of attorney time and a median of twenty-five percent of discovery time was spent on discovery and discovery motions).

87. In some cases courts can sanction parties for filing frivolous pleadings and motions. *See* 28 U.S.C. § 1927 (2012); FED. R. CIV. P. 11(c), 37(a). But not all socially suboptimal litigation is frivolous litigation; as we have seen, rational litigation conduct may be socially suboptimal. *See supra* Part I.A.1.

In short, the reforms that have been adopted and the reform proposals presently on the table do not provide courts with tools that are likely to alter the parties' rational but socially suboptimal behavior in many cases. Indeed, some of the reforms may exacerbate this behavior.

B. The Incentive to Engage in Privately and Socially Wasteful Litigation Practices

In some instances, parties make litigation decisions that are beneficial neither to themselves nor to society. The reforms to pleading, discovery, and pretrial also do little to address this cause of excessive spending.

1. The Problem

The situations in which parties invest more in litigation than they can expect to gain in return are varied. The first involves a nonneutral attitude toward risk. In the previous section, the analysis assumed that the parties were risk-neutral; they regarded a fifty percent chance of gaining $40,000 as equivalent to a sure $20,000. But a plaintiff may be a risk-taker, or a defendant a risk-avoider.[88] In either case, the party might prefer to spend more on discovery because of the hope (in the plaintiff's case) or the fear (in the defendant's case) of a larger judgment than risk-neutral parties expect.

Second, and relatedly, imperfect information may make a plaintiff unduly optimistic or a defendant unduly pessimistic about the likelihood of recovery, the amount of the recovery, or both.[89] For instance, if an optimistic plaintiff believes that she has a sixty percent chance of recovering $50,000 (even though, objectively, she has a fifty percent chance of recovering $40,000), she would be willing to spend as much as $30,000 on the case when a rational party would spend no more than $20,000. The same is true for the pessimistic defendant who

88. These attitudes toward risk will not be present in every case; plaintiffs are often risk averse, and defendants may be risk averse to risk neutral. *See* Keith N. Hylton, *The Economics of Third-Party Financed Litigation*, 8 J.L. ECON. & POL'Y 701, 708 (2012) ("In many real-world settings, the victim and the injurer will be risk averse."); Charles Silver, *"We're Scared to Death": Class Certification and Blackmail*, 78 N.Y.U. L. REV. 1357, 1408–16 (2003) (reviewing literature suggesting that plaintiffs are often risk averse but defendants may sometimes be risk neutral in large-scale litigation).

89. *Cf.* Robert D. Cooter & Daniel L. Rubinfeld, *An Economic Model of Legal Discovery*, 23 J. LEGAL STUD. 435, 444–50 (1994) (noting that one cost of discovery is the error in parties' decisionmaking attributable to the discovery of information that makes them unduly optimistic or pessimistic about their likelihood of success at trial).

believes that his chances of prevailing are forty percent and the judgment will be $50,000.

Imperfect information may also lead parties to make litigation decisions that seem rational initially but turn out to be costly. Assume, for instance, that a case has an expected value of $10,000, and the plaintiff can seek discovery that costs $300 but will increase the case value by $500. It seems rational to do so. But the defendant may seek to counteract this new evidence with other evidence that undercuts its value; for instance, assume that the cost of the defendant's response to the discovery request is $300, but the defendant can, at a cost of an additional $100, obtain evidence to impeach this discovery and reduce its value to the plaintiff to $50. Each individual move in this discovery game is rational (the plaintiff spends $300 to gain $500, and the defendant spends $400 to reduce liability by $450). Taking the long view, however, the plaintiff has spent $300 and the defendant $450 to improve the value of the claim by $50. The plaintiff's inability to know the full consequences of her actions can lead her to make a decision that she might not have made had she been better informed.[90]

Fourth, a party may spend excessively "for the principle of the thing." The party may be rich and very mad, or may be a public-interest organization dedicated to advancing a particular point of view. In any event, the economic benefit that the party derives from the suit is less than the money that the party is willing to put into it.

Fifth, the parties may expend money to recover sunk litigation costs. If a party has already expended $10,000 in litigation costs, the party's decision to spend the next $1,000 should hinge on whether the party can expect at least a $1,000 favorable change in the value of the claim; the $10,000 that has already been sunk into the litigation should not factor into this decision. But human beings often try to recover sunk costs and consequently make poor investment decisions.[91] Thus, a party might choose to spend $1,000 in additional litigation expenses in order to effect a $500 change in outcome, on the theory that enhancements in the outcome make it more likely that the party will recoup the sunk costs.

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90. This expenditure is excessive even if it is rational in absolute terms. If the plaintiff in this hypothetical stood to gain $5,000 net of costs, the expenditure of $300 to improve the claim value by $50 does not turn the case into a negative-value claim; the plaintiff still expects to realize a net gain of $4,750. Rather, the expenditure is irrational when viewed in marginal terms: the next dollar spent on litigation does not yield at least another dollar in added claim value.

91. *See* Samuel Issacharoff & George Loewenstein, *Second Thoughts About Summary Judgment*, 100 YALE L.J. 73, 113 (1990) ("Although economists exhort decision-makers to ignore sunk costs and to attend only to the prospective benefits and costs of alternative courses of action, few attain this ideal. Instead, individuals often incur further losses ('throw good money after bad') or take great risks in order to recover those losses.").

Each of these last five situations involves behavior in which a party acts under conditions of imperfect information or otherwise fails to act as *homo economicus* would. A sixth situation is different: it involves the problem of agency costs. Agency costs arise when: (1) the act that maximizes the agent's rational self-interest is not the act that maximizes the wealth of the agent's principal; (2) the principal is unable to monitor the agent's performance sufficiently; and (3) the agent chooses to maximize her wealth rather than that of the principal.[92] In the context of litigation, the principal is the client and the agent is the attorney. In a range of situations, an attorney who is interested in maximizing her fee may not advance the interests of her client to obtain the best result in the litigation.[93] For example, assume that an attorney may charge $300 per hour either to take a deposition that will last four hours or to submit interrogatories that will take one hour. The information that would be derived from each method is identical. The client prefers the attorney to choose the latter course, but the attorney prefers the former in the absence of more lucrative work elsewhere.[94] Unless the client monitors the work of the lawyer closely (an action that imposes costs on the client), the lawyer may run up the litigation bill.[95]

92. For a general discussion of agency costs, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) ("In most agency relationships the principal and the agent will incur positive monitoring and bonding costs (nonpecuniary as well as pecuniary), and in addition there will be some divergence between the agent's decisions and those decisions which would maximize the welfare of the principal." (footnote omitted)).

93. The literature applying the agency-costs problem to the conduct of lawyers is vast. *See, e.g.*, Kevin M. Clermont & John D. Currivan, *Improving on the Contingent Fee*, 63 CORNELL L. REV. 529, 546–50 (1978) (describing the diverging incentives of the client and the attorney under both hourly-fee and contingent-fee arrangements); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 12–27 (1991) (applying the theory of agency costs to both standard and class-action legal representation).

94. *See* Adam I. Muchmore, *Jurisdictional Standards (and Rules)*, 46 VAND. J. TRANSNAT'L L. 171, 226 (2013) ("For a defendant-side lawyer working under the traditional hourly fee arrangement, discovery costs are revenue, pure and simple. The more discovery is necessary in a case, the more the defendant's lawyer earns."); Frances Kahn Zemans, *Fee Shifting and the Implementation of Public Policy*, 47 LAW & CONTEMP. PROBS. 187, 192 (Winter 1984) ("[U]nder the American rule economic incentives . . . for hourly fee-for-service lawyers encourage more and greater discovery."); *see also* Weinstein, *supra* note 47, at 649–50 (arguing that "the lawyer's incentive to produce profitable billable hours," especially in cases involving "lodestar fee-setting rules or unvigilant clients," is a principal cause of discovery abuse).

95. The self-regarding lawyer's interest in using a more expensive discovery method is independent of the value of the information. For example, suppose that certain information is worth $1,000. Using a $1,200 deposition to obtain the information is clearly wasteful. If the information is worth $1,500, however, using a deposition seems worthwhile. But if interrogatories also yield $1,500 in value at a cost of $300, the deposition is wasteful. Indeed, the client may prefer the use of interrogatories even if it yields less valuable information. If interrogatories yield information worth $1,000 and the deposition yields information worth $1,500, the client should

This list of circumstances in which litigation advances neither private nor social interests is illustrative rather than exhaustive. It is possible that, in some instances in which a party acts in an economically irrational way, social welfare is advanced because the social value of the lawsuit exceeds the benefits that the party derives from it. But in many cases, litigation that is privately wasteful is also socially wasteful. The incentive to engage in such litigation varies under the American and English rules, but neither rule eliminates the incentives entirely.

2. The Ineffectiveness of Reforms in Addressing the Problem

Recent reform efforts—higher pleading bars, discovery limits, case management, and proportionality—do little to stem a party's irrational overinvestment in litigation. A higher pleading bar has no greater capacity to suppress excessive spending by irrationally optimistic, risk-taking, or principled plaintiffs than by risk-neutral ones, and we have seen that this bar has little effect on risk-neutral plaintiffs.[96] Similarly, a higher bar will have no effect on irrational decisions to recoup sunk costs, which typically arise later in the litigation. Finally, heightened pleading feeds into the hourly rate lawyer's desire to earn more fees, and real-options analysis shows that a higher pleading bar may also reduce the contingency-fee lawyer's reluctance to take on a weak case.[97] A higher pleading bar cuts indiscriminately across cases that are socially beneficial and those that are not. The bar is not geared to solve the problem of irrationally excessive litigation spending.[98]

Restrictions on the scope and amount of discovery will have some effect on parties willing to spend more on a lawsuit than it is worth and on lawyers seeking to maximize fees at their clients' expense. As described before, however, an unduly optimistic party or an inadequately monitored lawyer may simply channel the money that

prefer the use of interrogatories because the net gain ($500 vs. $300) is greater. In each scenario, however, the lawyer's interest is to take the deposition (and perhaps to ask the interrogatories as well).

96. *See supra* notes 52–57 and accompanying text. The effect that the higher bar is likely to have—making rational plaintiffs more likely to file suit—may be exacerbated when the plaintiff is unduly optimistic, risk-taking, or principled.

97. The reasons are equivalent to those that affect the plaintiff's decision to file suit. *See supra* note 5656 and accompanying text. In brief, a lawyer may decide to file an iffy claim when a heightened-pleading requirement makes it more likely that the claim will be dismissed at an early stage because the lawyer's time commitment before obtaining a decision about the claim's merit is less than it would be if the pleading standard were lower and the lawyer needed to invest more hours before the claim's merit was determined.

98. *See supra* text following note 53.

would have been spent on now forbidden discovery into still permissible but even less beneficial litigation activity.[99]

Other case-management techniques may have some modest effect. Nonbinding mediation or arbitration may provide an unduly optimistic or risk-taking party with a sober assessment of the value of a claim or defense. But those gains must be balanced against losses arising from the self-regarding lawyer who plays out every litigation strategy, including participation in ADR, to maximize fees rather than to advance the client's interest.[100]

Proportionality analysis can be helpful in dealing with excessive litigation spending. Because disproportional litigation expenditures benefit neither the parties nor society, the parties might be less resistant to the imposition of proportionality limits than they would be in cases in which those expenditures were privately worthwhile. Self-regarding lawyers, however, may still resist such limits. Moreover, the court still faces the daunting task of applying a series of indeterminate factors without sufficient information about the value or cost of discovery.[101] Finally, as previously described, proportionality limits apply only to discovery; the doctrine gives courts no power to limit litigation activities such as the selection of experts or the filing of motions.[102]

Overall, courts should be able to rein in irrational and excessive litigation expenditures more successfully than they can prevent rational but excessive expenditures. But that fact derives more from the inability of our present and proposed procedural rules to prevent rationally excessive spending than it does from their ability to hold down irrationally excessive spending. In neither case will courts be able to prevent a great deal of socially wasteful expense.

C. Summary

Courts should not suppress litigation activity when another dollar spent on litigation yields at least another dollar in social benefit.[103] If we start from this principle, which encourages socially

99. *See supra* text following note 60.

100. It bears repeating that the data show no perceptible savings from ADR. *See supra* note 73 and accompanying text.

101. *See supra* notes 81–83 and accompanying text.

102. *See supra* notes 86–87 and accompanying text.

103. Empirical evidence suggests that many cases fall within the bounds of both private rationality and social optimality. *See* Kakalik et al., *supra* note 10, at 636 (reporting that attorneys were generally satisfied with the discovery process); Willging et al., *supra* note 10, at 549 tbl.6, 551 tbl.8 (reporting that fifty-four percent of attorneys thought that the expense of discovery was about right in relation to the amount at stake in the case, and twenty percent thought them too

optimal investments in litigation, we see that barring access to the judicial process through heightened pleading or limiting access to information through controls on the scope and amount of discovery misses the boat. The issue should be whether access to the courts and to information is worth the cost. Across-the-board increases in the pleading bar and cuts in the scope or amount of discovery are crude, often counterproductive means to strike the cost-benefit balance.[104]

Among other reasons, these measures do nothing to limit the amount of money that parties actually spend on litigation.[105] These changes in pleading and discovery rules *might* be justified—but only if more refined instruments to align private and social incentives to litigate are lacking. Other instruments that have been suggested to deal with this issue—such as imposing taxes or fees on those who use the litigation system wastefully[106]—have enjoyed little traction.

Using a proportionality principle that aligns private expenditures with social benefits appears to be the best solution. But the principle must be structured in a way that is easy to implement and extends proportionality beyond discovery to all litigation activities. From this background the concept of the litigation budget emerges.

III. MANAGING COSTS BY BUDGETING

The basic elements of my proposal for litigation budgeting are simple. First, the lawyers for each party must prepare a budget that describes the hours they have spent and estimates the hours they will spend on each phase of a lawsuit, as well as the hourly rate for their work. Next, the lawyers must estimate all other expenses (for document production, for experts, and so on) that they will incur. The budgets are

low; further reporting that, according to the median attorney estimate, discovery constituted three percent of the total at stake in the litigation).

104. The principal problem with these measures is their single-minded focus on the cost side of the cost-benefit equation. *Cf.* Richard A. Epstein, *Of Pleading and Discovery: Reflections on* Twombly *and* Iqbal *with Special Reference to Antitrust*, 2011 U. ILL. L. REV. 187, 195–96 (arguing that, in establishing the right pleading bar, courts should consider both the cost of dismissing potentially meritorious suits and the cost of litigating potentially meritless suits); Bruce L. Hay, *Civil Discovery: Its Effects and Optimal Scope*, 23 J. LEGAL STUD. 481, 483 (1994) (arguing that "the social desirability of discovery depends on whether it induces, at acceptable cost, defendant precautions against harm").

105. *Cf.* Shavell, *supra* note 18, at 611 ("[R]egulation [of the pretrial and trial processes] by itself cannot lower litigation costs for a party").

106. *See id.* at 587–88, 611 (discussing taxes and fee shifting as options to deal with socially excessive litigation). As we have seen, shifting fees to the loser does not avoid the mismatch between private and socially desirable incentives to litigate. *See supra* notes 34–43 and accompanying text. Taxes may discourage socially undesirable litigation spending by one party. But taxes assessed against a plaintiff may also discourage socially valuable litigation, *id.* at 587, and taxes assessed against a defendant may increase the plaintiff's incentive to sue, *id.* at 588.

presented to the clients, to the other parties, and to the court before the first case-management conference.[107] Each party must either agree to the other's budget or file an objection. After receiving the parties' views, the court must either approve the budgets or modify them, and enter a "costs-management order" accordingly. The ultimate standard that the court must use in evaluating litigation budgets is simple: Are these total projected expenditures, including costs of judicial administration, less than the expected social value of the claim?[108]

This budgeting process focuses the clients, the lawyers, and the judge on the total expected costs and benefits of the case—including not only the private benefits and costs but also the public benefits and costs that extend beyond the case at hand.[109] A judge who believes that the total costs are excessive in relation to the total benefits of the case has a tool—downward modification of the parties' budgets—to ensure that costs are kept within bounds.

This Part lays out British and American antecedents to this litigation-budget proposal, in the process providing details about how an American litigation-budgeting system should operate. It then shows that this system corrects the problem of wasteful private incentives better than existing pleading, pretrial, and discovery reforms.

A. Adjusting the British Approach to the American System

This costs-management proposal is substantially based on the new costs-budgeting process in the United Kingdom. Like the United States, the United Kingdom has experienced issues with cost and delay in civil litigation. Through rule amendments widely known as the Woolf Reforms, the United Kingdom replaced its extant rules for civil courts with the Civil Procedure Rules, which came into force in 1999.[110] The

107. *See* FED. R. CIV. P. 16(a) (permitting a court to hold pretrial conferences for various purposes, including for "discouraging wasteful pretrial activities"); FED. R. CIV. P. 16(b)(1)(B), (b)(2) (requiring the court to issue a scheduling order, which may occur after a scheduling conference, within the earlier of 120 days after service on any defendant or ninety days after the appearance of any defendant).

108. This standard requires more specificity to work in practice. For further discussion, see *infra* Part III.A.

109. *See supra* notes 17–20 and accompanying text.

110. The reforms were named for Harry Woolf, then Master of the Rolls and later Lord Chief Justice of England and Wales. Lord Woolf's report recommended numerous changes in the rules governing civil litigation. LORD WOOLF, ACCESS TO JUSTICE (1996). The Civil Procedure Act 1997 conferred the power on the Civil Procedure Rules Committee to enact rules of procedure for civil courts. Civil Procedure Act, 1997, c. 12, §§ 1–2 (Eng. & Wales). The Committee promulgated the initial Civil Procedure Rules on December 10, 1998; they became effective on April 26, 1999. Civil Procedure Rules, 1998, S.I. 1998/3132, Introductory Text, *available at* http://www.legislation.gov.uk/uksi/1998/3132/introduction/made, *archived at* http://perma.cc/CW6F-

Civil Procedure Rules tackled the problems of cost and delay principally by expanding the judge's case-management powers.[111] The Woolf Reforms were generally regarded as successful insofar as reducing delay was concerned, but they did far less to abate—and may even have increased—the cost of litigation.[112] After roughly ten years of experience with the Woolf Reforms, Lord Justice Jackson recommended another series of reforms to the Civil Procedure Rules to control costs. Included in these reforms, which became effective on April 1, 2013, were "costs budgets."[113]

The Civil Procedure Rules spell out the process that make the costs-budget system work. Barristers prepare their budgets on a schedule (or "precedent") that requires them to state their charges for the services that they have completed for their clients (such as prefiling and pleading activities) and then to estimate the charges for remaining tasks (such as discovery and trial). Additionally, barristers must also include other expenses (such as fees for expert witnesses) as separate line items.[114] The parties exchange their budgets in advance of a costs-management conference.[115] If the parties agree with their opponent's budget, the court records the agreement, and those costs are settled; the

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NGQ7. A copy of the Civil Procedure Rules presently in force may be accessed at the Ministry of Justice website, http://www.justice.gov.uk/courts/procedure-rules/civil/rules, *archived at* https://perma.cc/384K-FBFF?type=source.

111. *See* Neil H. Andrews, *A New Civil Procedural Code for England: Party-Control "Going, Going, Gone,"* 19 CIV. JUST. Q. 19, 23–27 (2000) (outlining the judge's expanded case-management powers).

112. *See* Neil H. Andrews, *Accessible, Affordable, and Accurate Civil Justice—Challenges Facing the English and Other Modern Systems* 3–4 (Univ. of Cambridge, Legal Studies Research Paper Series, Paper No. 35/2013, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2330309, *archived at* http://perma.cc/KVL4-GERE (noting that litigation costs had been steadily increasing in recent years).

113. *Id.* at 11–13.

114. *See* CPR 3.13 ("Unless the court otherwise orders, all parties except litigants in person must file and exchange budgets as required by the rules or as the court otherwise directs."); Practice Direction 3E, ¶ 6, *available at* http://www.justice.gov.uk/courts/procedure-rules/civil/rules/part03/practice-direction-3e-costs-management, *archived at* http://perma.cc/2D3W-A4G9 (last visited Feb. 5, 2015) ("Unless the court otherwise orders, a budget must be in the form of Precedent H annexed to this Practice Direction."). Precedent H contains twelve line items that constitute the costs budget: preaction, issues and pleadings, case-management conference, disclosure, preparation of witness statements, expert witnesses, pretrial review, trial preparation, ADR and settlement discussions, and contingent costs. For each item, the parties must identify the assumptions on which the costs are based, as well as the monetary disbursements and hours for items that have already been incurred and those that are estimated. Precedent H, *available at* http://www.justice.gov.uk/courts/procedure-rules/civil/pdf/update/precedent-h.pdf, *archived at* http://perma.cc/46Q8-F526. For the Ministry of Justice's guidance on how to fill out Precedent H, see Guidance Notes on Precedent H, *available at* http://www.justice.gov.uk/courts/procedure-rules/civil/pdf/update/new-precedent-h-guidance.pdf, *archived at* http://perma.cc/DP7Z-WYWV (last visited Feb. 5, 2015).

115. CPR 3.13, 3.16.

court has power to approve or modify a portion of a budget only when an opposing party refuses consent.[116] If later circumstances warrant, the court may modify the costs-management order.[117]

Importing this process into the American system requires some adjustments. First, the issue of litigation budgets[118] should be an additional subject for the scheduling conference,[119] rather than the subject of a separate costs-management conference. Second, if the goal is to ensure cost-effective spending on litigation, the parties' consent to each other's budgets should not command automatic judicial approval;

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116. *See* CPR 3.15(2) (requiring the costs-management order to "record the extent to which the budgets are agreed between the parties," and then "in respect of budgets or parts of budgets which are not agreed, record the court's approval after making appropriate revisions"). Thus, the court appears powerless to revise costs on which the parties agree. *See* STUART SIME, A PRACTICAL APPROACH TO CIVIL PROCEDURE § 16.19 (16th ed. 2013) ("The primary position is that costs budgets should be agreed by the parties."); Practice Direction 3E, ¶ 7.3 ("In so far as the budgets are not agreed, the court will review them and, after making any appropriate revisions, record its approval of those budgets."). With respect to approving those parts of a budget on which there is no agreement, the Civil Procedure Rules provide no standard. But the Rules twice refer to the need for costs management to satisfy "the overriding objective" of litigation. *See* CPR 3.12(2) ("The purpose of costs management is that the court should manage both the steps to be taken and the costs to be incurred by the parties to any proceedings so as to further the overriding objective."), 3.15(2) (discussing the court's power to make a "costs management order" to record and approve costs). The first Civil Procedure Rule describes "the overriding objective of enabling the court to deal with cases justly and at proportionate cost." CPR 1.1(1). Rule 3.15(2) indirectly suggests the same standard, stating that a court must enter a costs-management order "unless it is satisfied that the litigation can be conducted justly and at proportionate cost in accordance with the overriding objective without such an order being made." The Practice Direction implementing costs budgeting is in accord, stating that that a court "will consider whether the budgeted costs fall within the range of reasonable and proportionate costs." Practice Direction 3E, ¶ 7.3; *cf.* CPR 44.3(1) (stating that, in its decision to award costs, "the court will not . . . allow costs which have been unreasonably incurred or are unreasonable in amount").

117. *See* CPR 3.16(1) (noting the power to hold a costs-management conference to "approve a revised budget").

118. I use the term "litigation budgets" rather than "costs budgets" to describe my proposal, partly to distinguish the extant English approach from my proposal for American courts and partly to reflect the reality that "costs" has different meanings in English and American practice; in particular, in American courts "costs" are not usually understood to include attorney's fees. *See* 28 U.S.C. § 1920 (2012) (listing costs that a clerk may tax; not listing attorney's fees); FED. R. CIV. P. 54(d) (allowing a judge to award costs other than attorney's fees to a prevailing party, and creating a separate process for the award of attorney's fees when they can be recovered).

119. *See* FED. R. CIV. P. 16(b) (requiring a scheduling order in certain federal cases). Although a scheduling conference is not required before the issuance of a scheduling order, scheduling conferences are common. *See* FED. R. CIV. P. 26(f)(1) (requiring parties to attend a discovery-planning conference "at least 21 days before a scheduling conference is to be held or a scheduling order is due under Rule 16(b)"). In cases in which no scheduling conference is held, the parties would submit their budgets, as well as any objections to other parties' budgets, along with the discovery plan. *See* FED. R. CIV. P. 26(f)(2) (requiring the submission of a discovery plan to the court within fourteen days of the parties' discovery-planning conference). Like any pretrial order, a court should be able to amend a costs-management order. *See* FED. R. CIV. P. 16(b)(4) (permitting the modification of scheduling orders "for good cause and with the judge's consent"), 16(d) (permitting the modification of other pretrial orders).

the court should retain some role in ensuring that the budgets are reasonable and proportionate from society's standpoint.[120] Third, for reasons explained later, the court should include specific line-item limits for expenditures on affirmative discovery (discovery that the party requests), responding to the discovery requests of the opposing party, moving to compel discovery, and making pretrial motions.[121]

Other features of the English costs-budget system, however, require substantial tailoring for the American context. First, British budgets do not include all the costs that parties can expect to incur; although all of the fees paid to barristers are awardable, a portion of the fees that clients pay to their solicitors, who do substantial work in civil litigation, are not.[122] Whatever the merits of that distinction in a system that separates the work of barristers and solicitors,[123] American litigation budgets should include all the expenses incurred by lawyers. Otherwise, the point of the litigation budget—to keep the total costs of litigation to a socially appropriate level—could be easily circumvented.

Second, the British costs-budgeting process ordinarily applies only to "multi-track cases."[124] There is no precise American analogy to this category, but the idea of excluding some cases from litigation budgeting is sensible. In federal court, certain cases—which typically involve little to no discovery—are excluded from scheduling-order and

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120. For further discussion of the role that the parties' consent to one another's budgets should play in the judge's decision, see *infra* note 155 and accompanying text, *infra* text following note 167.

121. *See infra* notes 146, 149–50, and accompanying text; *infra* text following note 193.

122. *See* SIME, *supra* note 116, § 46.01 (dividing solicitors' costs into "contentious costs," which can be recovered, and "non-contentious costs," which cannot); *id.* § 46.02 ("[E]ven a successful litigant usually has to pay something to its own solicitor . . . .").

123. *See id.* §§ 1.06–.17, 1.21 (describing the division of responsibility between barristers and solicitors with respect to litigation).

124. CPR 3.12(1). There are exceptions; multi-track cases with a monetary value exceeding £10 million are exempt from costs budgeting, CPR 3.12(1)(a)–(b), as are "multitrack" cases that are subject to "fixed cost or scale cost," CPR 3.12(1)(c). The court can also exempt a multi-track case from costs budgeting by order. *Id.* Conversely, the court may order parties in cases not on the multi-track to file budgets. CPR 3.12(1A).

One of the innovations of the Woolf Reforms had been to divide cases into three tracks: "multi-track cases," "small claims cases," and "fast track cases." Andrews, *supra* note 111, at 24–25. "Multi-track cases" are defined as cases that are neither "small claims cases" nor "fast-track cases." *See* CPR 26.6(6) ("The multi-track is the normal track for any claim for which the small claims track or the fast track is not the normal track."). In general, "small claims" cases are those personal-injury cases whose value does not exceed £10,000 and whose claim for pain and suffering does not exceed £1,000, other cases whose value does not exceed £10,000, and certain landlord-tenant disputes. CPR 26.6(1)–(3). Typically, "fast track" cases involve claims whose value does not exceed £25,000, the trial will likely last no more than one day, and expert witnesses are limited. CPR 26.6(4)–(5). Other factors, such as the number of likely parties, the complexity of the issues, and the importance of the case to nonparties, can influence the court's decision in assigning a case to a given track. *See* CPR 26.8.

mandatory-disclosure requirements.[125] These cases are strong candidates for exclusion from American costs budgeting, as are cases of low aggregate value.[126]

Third, in the United Kingdom the consequence of failing to submit a costs budget is draconian: the party cannot recover the bulk of its costs should it win.[127] Because the United States does not generally use a loser-pays rule,[128] the sanction for noncompliance must be different. But this fact poses no significant hurdle. The Federal Rules already contain an ample set of sanctions that can be brought to bear on parties that fail to obey scheduling or case-management requirements;[129] the same powers should be available to ensure that parties abide by their obligations to file litigation budgets.

A fourth, and critical, difference in the two systems arises from the nettlesome problem of enforcing the parties' obligation to stay within their budgets. British courts enforce the obligation through the expedient of limiting the costs awarded to the prevailing party to the amount in the budget.[130] This mechanism, however, is an imperfect way to control costs. Any party who wants to spend more than the costs budget allows may do so, on the understanding that the money is coming from the party's pocket. Parties have an incentive to spend more

125. *See* FED. R. CIV. P. 16(b) (stating that "categories of actions exempted by local rule" need not comply with the scheduling-order process); FED. R. CIV. P. 26(a)(1)(B) (exempting certain cases from mandatory disclosure).

126. Following the British approach, which excludes cases whose value does not exceed £25,000 (roughly $40,000 at the present rate of exchange), an appropriate cut-off for costs budgeting might be a case with an aggregate value of $50,000. By "aggregate value," I mean the total value of all claims and counterclaims. A class action of one million members, each of whom has a $100 claim, would require costs budgeting.

127. CPR 3.14 ("Unless the court otherwise orders, any party which fails to file a budget despite being required to do so will be treated as having filed a budget comprising only the applicable court fees."); *see* Mitchell v. News Grp. Newspapers Ltd., [2013] EWCA (Civ.) 1537, [2014] 1 W.L.R. 795 (Eng.) (holding that, due to his solicitor's tardy submission of a costs budget, a party would not be entitled to recover costs, which were listed as £506,425, should he ultimately prevail).

128. *But see supra* note 15 (mentioning circumstances in which a loser-pays rule is employed in American courts).

129. FED. R. CIV. P. 16(f).

130. In awarding costs "on the standard basis," a British court can deviate from the amount listed in "an approved or agreed budget" only when it is "satisfied that there is good reason to do so." CPR 3.18(b). Costs budgeting does not have an effect on the award of costs when the award is not made on the standard basis. For instance, in some cases, costs are awarded on "the indemnity basis." CPR 44.3(1)(b). Under the "indemnity principle," a losing party must pay only those of the winning party's attorney's fees that the winning party would have been required to pay its attorney if it had lost. SIME, *supra* note 116, § 46.54. In addition, some types of cases, such as low-value car accidents, involve the award of fixed and scale costs. *See* CPR Part 45 (pertaining to fixed costs); SIME, *supra* note 116, § 46.62 (describing fixed and scale cost cases). Because many of the fixed-cost cases would not be on the multi-track, costs budgeting would be inapplicable in any event.

money than permitted in the budget if doing so influences the expected recovery by more than the amount expended—even if the added expenditure would not be socially beneficial.[131]

But even this imperfect method of enforcement is unavailable in American courts, which typically do not employ the loser-pays rule on which the English system builds costs budgeting. If litigation budgeting is to work on this side of the Atlantic, parties must not be permitted to spend more than the amount approved in the budget without judicial approval of the budget modification. The issue is how to enforce this obligation.

Two methods are possible. One is to limit the clients' obligation to pay their lawyers to the amount listed in the budget for that aspect of the case. The other is to require the lawyer or party who overspends the budget to indemnify other parties and the court for the reasonable costs that they expend responding to the overspending.[132] This indemnity approach is a tax of the type described by Professor Shavell—one that requires a party who chooses to use public resources inefficiently to bear the costs of doing so.[133] But the indemnity approach also suffers from certain flaws. It comes into play only when a party's overspending affects other parties or the court, and it may lead to satellite litigation about which responsive expenses are "reasonable." Therefore, the first mechanism—limiting the client's responsibility for fees and costs to the amount contained in the budget—seems more desirable.

Of course, this mechanism does not prevent collusion between a client and lawyer to spend more than the budget permits. For two reasons, however, the prospect of collusion is remote. First, even if the

131. For example, assume that a plaintiff's case is worth £100,000, and the plaintiff has a seventy-five percent chance of prevailing. The court establishes a costs budget that, in total, allows expenditures of £30,000 per side; the court's own costs are £14,000. The case is socially beneficial because total costs (£74,000) are less than expected benefits (£75,000). Now assume that if the plaintiff spends an extra £7,000, the chance of recovery increases to eighty percent. The total costs (£81,000) now exceed the total benefit (£80,000). It might seem anomalous that the plaintiff would spend £7,000 to increase the value of the claim by £5,000, but in a loser-pays system, spending an extra £7,000 increases the net recovery from £60,000 (£75,000 in expected recovery less £15,000 in expected costs (i.e., a twenty-five percent chance of bearing both parties' budgeted costs of £60,000)) to £68,000 (£80,000 in expected recovery less £12,000 in expected costs (i.e., a twenty percent chance of bearing both parties' budgeted costs of £60,000)). Because £7,000 in additional investment yields £8,000 in private gain, the British plaintiff will make this socially undesirable investment.

132. Whether the lawyer or the client should be responsible for this indemnity would depend on whether the client authorized the additional work. Extending the idea of indemnity to its logical endpoint, a party could in theory opt out of the budget limits established by a court by agreeing to indemnify the other party for reasonable costs incurred by that party over and above its budget.

133. *See supra* note 106 and accompanying text.

client initially agrees to pay more to the lawyer, the client has an incentive to renege on the deal and turn the lawyer in when it comes time to pay the fee—at least if the court rigorously requires the lawyer to decline or disgorge any improper fee.[134] Second, under the American rule, the client has no reason to accede to the lawyer's request for an additional fee unless the amount of the fee increases the expected recovery in an amount greater than the fee. Assuming that the collusive additional work the lawyer performs causes no additional work for the opponent or court, the additional work is socially worthwhile, and the lawyer should be able to request and obtain an upward modification of the budget without the need for collusion. Assuming that the collusive additional work also causes additional work for the other party or the court, the other parties and the court will act as monitors that should expose the collusion. Moreover, the court can contain the risk of collusion by requiring the client and lawyer to certify that the client paid no more, and the lawyer received no more, than the budgeted amounts for the services rendered. Granted, a certification system is imperfect, but the small amount of collusive behavior might slip through is an unavoidable cost of a system that should control litigation expenditures far better than the present system.

Although the principal inspiration for costs budgeting comes from England, parties have occasionally been required to submit litigation budgets in American courts. For instance, in *In re Consumers Power Co. Securities Litigation*, the court required "the filing of a statement of proposed expenses by the plaintiffs and a budget."[135] The point of the budget was to make sure that the class representatives, who were required to bear the costs of the litigation, were fully informed of the amount of money that they were agreeing to pay. In *In re Oracle Securities Litigation*, the court required law firms bidding for the role of lead counsel in a class action to file litigation budgets with their bids.[136] The point of this budget was to help to determine the lead counsel that would best represent the class. On the criminal side, attorneys appointed under the Criminal Justice Act may be required to

134. If the client and lawyer have an ongoing relationship, however, this check on collusion is less likely to be effective.

135. 105 F.R.D. 583, 607 (E.D. Mich. 1985).

136. 131 F.R.D. 688, 690–91 (N.D. Cal. 1990). Although the use of bids to select lead counsel enjoyed some popularity for a period of time, *see* Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650, 664–67 (2002) (describing details of the auction process), auctions came to a screeching halt when the Third Circuit forbade nearly all lead-counsel auctions under the Private Securities Litigation Reform Act of 1995. *In re* Cendant Corp., 264 F.3d 201, 277 (3d Cir. 2001).

file budgets.[137] These budgets ensure that criminal defendants receive an adequate defense while preserving scarce public funds.

In none of these instances was the purpose of litigation budgeting precisely the same as it is in this proposal: to counteract the parties' incentive to overspend on civil litigation. Indeed, the closest American antecedent to costs budgeting is the proportionality requirement of Rule 26.[138] As we have seen, proportionality is the right idea for containing excessive litigation costs; unfortunately, it lacks a ready means of enforcement and is limited in scope to the discovery process.[139] Litigation budgeting overcomes both constraints. Budgeting provides a practical way to ensure that expenditures are worth their cost, at the same time avoiding ad hoc and ex post assessments of present proportionality analysis. Because it applies to all aspects of the litigation process, litigation budgeting also expands the proportionality principle to the entire litigation process. Indeed, litigation budgeting is the logical endpoint of proportionality.

Nevertheless, adopting judicial costs management would be a significant change in American legal practice. It can be justified only if it eliminates the parties' incentives to engage in socially wasteful litigation practices more effectively than alternatives. The following section demonstrates that a litigation-budget process does so better than the reforms considered in Part II.

B. How Budgets Control the Incentive to Overspend

As we have seen, in some cases a party's incentive to spend excessively on litigation is rational: because the party does not absorb all of the costs of its action, its expenditures lead to private gain but social loss.[140] In other cases a party's incentive is not rational: imperfect information, nonneutral risk preferences, or agency costs cause excessive spending.[141] Because they directly cap expenditures at a socially justifiable level, litigation budgets have the potential to curtail both rational and irrational overspending.

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137. *See* Hanna v. Bagley, No. 1:03–cv–801, 2014 WL 1342985, at *1 (Apr. 3, 2014) (noting that "[p]roposed budgets and resulting budget orders [in capital habeas cases] are not only filed under seal, but also *ex parte*"); U.S. DISTR. COURT FOR THE DISTR. OF MD., CRIMINAL JUSTICE ACT PLAN §§ VIII.C, IX.C, X.F (2004) (requiring appointed counsel to file budgets in capital habeas cases and capital prosecutions, and giving the court discretion to order "appointed counsel to prepare and submit budgets in non-capital cases").

138. *See supra* notes 75–80 and accompanying text.

139. *See supra* notes 81–87 and accompanying text.

140. *See supra* Part II.A (explaining how myopic litigants weigh their private gain without considering the net effect on society as a whole).

141. *See supra* Part II.B.

For litigation budgets to do so, however, two conditions must hold true. First, the judge must set the budgets at a level where expected social gains exceed expected social costs. Second, the parties must stay within their budgets. The latter issue I have already discussed;[142] the former I discuss later.[143] In this Section, I assume that both conditions pertain. Under these conditions, litigation budgeting is the best way to address the root causes of excessive spending on litigation.

1. Controlling the Incentive to Overspend when Private Gains Exceed Private Costs

Litigation budgeting makes sure that the total costs of litigation, not just the costs that the party making the expenditure will incur, bear on decisions about spending. No party can spend an amount that is privately rational but socially excessive. On the assumption that budgets are both set appropriately and complied with, spending is also justified from society's perspective.

In particular, litigation budgeting can control the resort to scorched-earth tactics and impositional discovery. Parties cannot respond with overwhelming force as a way to deter future lawsuits because the budget ensures that the costs of the present case remain proportional to the needs of the present case.[144] Budgeting also contains, although it does not completely eliminate, the parties' incentive to impose costs through discovery. By definition, impositional discovery is cheap to request, of limited value to the requesting party, and very costly to the responding party.[145] Under a litigation-budget approach, each party is budgeted a certain amount of money to respond

142. *See supra* notes 130–33 and accompanying text.

143. *See* in*fra* Part IV.A.

144. *See supra* note 44 and accompanying text (discussing a "scorched earth" litigation tactic for which the only purpose is to impose costs on the opposing party). In setting the costs budget, a court may consider the fact that one party (say, the defendant) is a repeat player who is likely to face related litigation and provide the defendant with a budget sufficient to address certain one-time costs (such as the cost of producing voluminous discovery) that the defendant will incur in responding to discovery in the first lawsuit. If the court segregates the line items on the budgets for obtaining discovery, responding to discovery, and making pretrial motions, *see supra* note 121 and accompanying text, the line items for taking discovery and making motions should still be set with the value of the present litigation in mind; only the line item for responding to discovery should be adjusted upwards. Thus, litigation budgeting thwarts a repeat player's attempt to take excessive discovery or file excessive motions as a cudgel to discourage future litigation. Conversely, if the plaintiff's discovery in the present case might be usable by other plaintiffs suing the defendant in later cases, the court might adjust the plaintiff's budget for obtaining discovery upward.

145. *See supra* notes 45–48 and accompanying text.

to other parties' discovery requests. Once a responding party hits the limit for producing information, it has no obligation to produce more discovery—unless the court increases the production budget.[146] Thus, parties have little incentive to use impositional tactics because with those strategies, the requested information has no value, and the opponent's cost of responding to the request eats into the resources available to obtain valuable discovery. Indeed, the parties now have an incentive to go after the highest-value information at the outset, before the responding party's production budget runs out.[147]

Litigation budgeting is less likely to be effective against responsive practices like stonewalling or document dumping. This fact is not surprising: the proportionality principle from which litigation budgeting derives has more difficulty regulating costly responsive practices than regulating costly requesting practices.[148] Indeed, the use of budgets could even encourage both stonewalling and document dumping. Stonewalling forces the opponent to spend its allotted budget pursuing the requested information, potentially exhausting its resources without obtaining anything useful in return. Document dumping forces an opponent to squander its limited discovery budget on sorting through the chaff to find a grain of wheat.

But countervailing forces are also at work, especially with respect to stonewalling. Resisting discovery draws down the resources of the party who stonewalls as well as those of the party who requests. In addition, one reason for a lawyer to stonewall is to garner fees; by resisting discovery for as long as possible, and then capitulating, the hourly fee lawyer earns more money than by promptly providing

146. Before allowing an amendment to increase in the budget, the court should satisfy itself that (1) changed circumstances about the expected value of the case warrant an increase and (2) neither past discovery requests nor the present requests are impositional. Because a motion to amend the budget is an expense that would come out of the moving party's line item for making pretrial motions, parties would not be likely to make such a motion unless it was essential—an indirect control that further limits the likelihood of impositional discovery requests.

In a litigation-budget world, the problem of impositional discovery is most likely to arise in cases of asymmetrical information, in which one party has little discoverable information and the other party has a great deal. In cases of symmetrical information, neither party has a great incentive to engage in impositional discovery. Should one party do so, the other party could respond in kind; the mutual assured destruction of each other's production budget would likely serve neither party's interest.

147. Of course, placing a line-item limit on responding to discovery opens the way for gamesmanship; a responding party may spend the entire budget producing the first ten sheets of paper and then claim that it has no more money to produce more discovery. When presented with such a scenario, the court must be willing to sanction a party both by requiring full production and by subtracting the further costs of this production from other portions of the budget.

148. *See supra* text following note 85.

responsive discovery.[149] With a litigation budget, however, the fees that a lawyer can earn for responding to discovery are capped; thus, any fees earned for stonewalling are fees not earned for litigation activities that might be more productive for the client's case. Finally, if a court finds that stonewalling occurred, a ready and effective sanction would exist under a litigation-budget system: charging to the stonewalling party's discovery budget the costs of the opponent in obtaining the information.[150] Because this sanction would thus reduce a stonewalling party's own capacity to obtain discovery, each party has a greater incentive to be forthcoming.

The picture is less rosy for the litigation budget's capacity to prevent document dumping. Knowing that the opponent's budget for responding to discovery is limited, a party has reason to overwhelm the opponent with useless, costly-to-process information. Akin to impositional discovery, one tool that a court may employ to reduce the incidence of dumping is to assess the requesting party's costs of sorting through a document dump against the responding party's budget, thus impairing the responding party's ability to conduct its own discovery. But this sanction can work as a deterrent only if the court can discern document dumping from a legitimately broad discovery response.

The most effective way to avoid document dumping is for the requesting party to tailor specific requests instead of "fishing expedition" requests that invite dumping. Tailored requests also make it easier for courts to assess whether dumping has occurred and to impose a sanction when it has. Indeed, one advantage of litigation budgeting is its encouragement of tailored discovery. Recall that a requesting party may have a rational incentive to spend more on discovery and pretrial than society wishes. In these cases, a litigation budget limits the party's ability to spend. A rational party will therefore seek the most valuable information during discovery. Although litigation budgeting can do little to prevent document dumping directly, it can exercise a disciplinary effect that curtails the "fishing expedition" practices that invite dumping.

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149. To the extent that the fees paid to stonewall are less than the change in litigation value that would ensue if the information were disclosed, the rational client might want the lawyer to stonewall. On the other hand, to the extent that the fees paid are more than the change in litigation value, the client would rationally prefer that no stonewalling occur. This latter type of stonewalling imposes agency costs on the client. *See supra* notes 92–95 and accompanying text. Litigation budgeting can respond to both causes of stonewalling.

150. *Cf.* FED. R. CIV. P. 37(a)(5)(A)(ii) (permitting a court to award to a party who successfully moves to compel discovery its reasonable expenses, including attorney's fees, unless "the opposing party's nondisclosure, response, or objection was substantially justified").

Courts must still be vigilant about stonewalling and document dumping. For the most part, litigation budgets will not make the tendency to engage in stonewalling worse, and in some ways budgeting may ameliorate the problem. Litigation budgets increase the incentive to dump documents, but lawyers can tailor discovery requests to limit the problem. The power to assess costs against the offending party's budget also creates a new and effective tool to discourage stonewalling and dumping. Even if some of this behavior remains, the caps on spending that litigation budgets impose ensure that, overall, the amounts spent on litigation will be both privately and socially worthwhile.

2. Controlling the Incentive to Overspend when Private Costs Exceed Private Gains

Litigation budgeting can also control the parties' desire to spend more on litigation than the likely private gain. Because the court can take the broad view in setting the parties' budgets, it can avoid distorting influences such as excessive optimism or pessimism, nonneutral attitudes toward risk, or the desire to overspend in order to recover sunk costs. Nor is the court seeking to vindicate "the principle of the thing," so it can keep a reasonable cap on expenditures. Most significant, costs budgets control agency costs. Lawyers have a budget within which they must live; they cannot run up their fees with excessive discovery and motion practice.

Of course, the court must be capable of assessing objectively the plaintiff's chances of recovery and the likely amount of recovery.[151] For this reason, obtaining the input of the parties on the litigation budgets is useful, as is experience on the bench and a willingness to amend a budget (upward or downward) when initial impressions prove wrong. The capacity of litigation budgets to break through the seemingly intractable problems of agency costs and irrational impulses to overspend is one of the strongest arguments for their use.

IV. OBJECTIONS TO COSTS MANAGEMENT

Perhaps the most visceral reaction to litigation budgeting is "A court can't do that!" Beneath this reaction lie claims either that (1) courts lack a meaningful standard for setting the budget; (2) litigation budgeting is unwise because of practical impediments, such as the

151. *Cf.* Chris Guthrie et al., *Inside the Judicial Mind*, 86 CORNELL L. REV. 777, 784 (2001) (describing the results of psychological testing showing "that under certain circumstances judges rely on heuristics that can lead to systematically erroneous judgments").

difficulty of adapting budgets to contingency-fee cases or the potential for gamesmanship; or (3) courts lack the legal and constitutional power to intrude so deeply into the sphere of attorneys and clients. Although some of these critiques are articles unto themselves, this Part evaluates each argument, in the process fleshing out further important details about litigation budgeting.

A. Objection One: The Standard for Setting Budgets

Until now, I have assumed that a court can accurately assess the social benefits and costs of a lawsuit, assess the private costs of the lawsuit, and prepare a budget accordingly—all with very little knowledge about the nature or strength of the case. Obviously a court cannot do so with perfect accuracy in every case. But the fear is that judges will rely on prejudgments about the worth of certain types of cases, and budgets will take on a "chancellor's foot" quality in which the budgets that the parties receive for comparable claims will vary widely from courtroom to courtroom.[152]

A time-honored way to control judicial discretion is to provide factors that a court must weigh in setting the budgets. The factors would likely be those that already guide a court's proportionality analysis: "the needs of the case, the amount in controversy, the parties' resources, the importance of the issues at stake in the action, and the importance of [the pretrial and trial measures] in resolving the issues."[153] But such factors seem no less fuzzy when applied at the outset of a case to establish budgets than they are in the heat of a case to decide the proportionality of a request for discovery.[154]

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152. *Cf.* Lonchar v. Thomas, 517 U.S. 314, 323 (1996) (describing Selden's famous observation that "to use each equity chancellor's conscience as a measure of equity . . . would be as arbitrary and uncertain as measuring distance by the length of each chancellor's foot").

153. FED. R. CIV. P. 26(b)(2)(C)(iii) (explaining that the court can limit discovery if the burden of the request will outweigh its benefit). The English system comes to a similar place. The primary consideration in setting the parties' costs budgets is the parties' consent. CPR 3.15(2)(a). In case of disagreement, the court must "further the overriding objective," CPR 3.12(2), 3.15(2)(b), which requires the court "to deal with cases justly and at proportionate cost," CPR 1.1(1). In the related context of awarding costs at the end of litigation, the court may award only those costs "proportionately and reasonably incurred" and "proportionate and reasonable in amount" in cases awarded on the standard basis, CPR 44.4(1)(a)(i)–(ii), and "reasonably incurred" and "reasonable in amount" in cases awarded on an indemnity basis, CPR 44.4(1)(b)(i)–(ii). Among the factors guiding this decision, in addition to the "last approved or agreed budget," CPR 44.4(3)(h), are "the conduct of all the parties," CPR 44.4(3)(a); "the amount or value of the money or involved," CPR 44.4(3)(b); "the importance of the matter to all the parties," CPR 44.4(3)(c); "the particular complexity of the matter or the difficulty or novelty of the questions raised," CPR 44.4(3)(d); and the lawyer's skill and time spent on the case, CPR 44.4(3)(e)–(f).

154. *See supra* notes 81–84 and accompanying text (discussing the difficulty of applying the present proportionality standard).

Perhaps this difficulty is why the English approach initially puts the matter of budgets into the parties' hands, requiring the court to accept their budgets to the extent they consent.[155] This approach also makes sense in the British context for other reasons. Because the losing party is liable for the winner's costs but neither party knows at the outset who will lose, both sides have an incentive to keep costs reasonable. Moreover, there is a certain rough justice in assessing costs to which the other party, with an opportunity to object, has consented.

But consent cannot serve as the basis of the American approach. Without a loser-pays rule but with the American adversarial tendency to seek any advantage, parties would rarely consent to their opponents' budgets. Moreover, relying on consent raises the prospect of collusion, in which one lawyer consents to the other side's oversized budget in return for the other lawyer's tacit agreement not to dispute its own oversized budget.

So how is a court to approve a budget? The court's first step must be to determine the potential *private* benefit of a lawsuit. In determining this benefit, the court should start with the claimant's position. In federal court, plaintiffs already disclose to their opponents "a computation of each category of damages" by the time that the scheduling order is issued.[156] If this computation were shared with the court before the scheduling conference,[157] the court would have the plaintiff's assessment of the value of the case.[158] A claimant has an incentive not to puff the claim's value unduly; an unrealistically high valuation might induce a judge to award a larger budget to the defendant, who then would have more funds with which to engage in scorched-earth or impositional tactics.

This computation is only a starting point; no judge should blindly accept a party's estimate of the value of a case. Sometimes a judge's experience provides some sense of the case's value. The court should also rely on statistical evidence. As part of a litigation-budget initiative, the Federal Judicial Center, which conducts statistical analyses of the federal docket, should determine the mean and median values at settlement (and after trial) for basic categories of cases on the

155. *See supra* note 116 and accompanying text.

156. *See* FED. R. CIV. P. 26(a)(1)(A)(iii) (requiring disclosure to an opponent of a computation of damages and the evidence on which it is based); 26(a)(1)(C) (requiring disclosure to be made within fourteen days of the parties' Rule 26(f) conference); 26(f)(1) (requiring the parties' conference to be held at least twenty-one days "before the scheduling conference is to be held or a scheduling order is due").

157. On the blending of the scheduling and costs-budgeting tasks into one conference, see *supra* note 119 and accompanying text.

158. The obligation to disclose damage computations should be broadened to require an estimation of the value of injunctive relief.

federal civil docket, as well as the success rates of the cases that go to trial.[159] This information will provide judges with a rough idea of the expected value of claims—a benchmark by which they can test against their experiences and the parties' submissions.

The expected value of the lawsuit to the plaintiff should presumptively be regarded as the full benefit of the lawsuit. Some lawsuits involve private benefits beyond the relief obtained.[160] But these benefits may be difficult to quantify. They may also be socially undesirable. For instance, the litigation may be designed to stifle socially beneficial competition from the plaintiff's competitors. Therefore, except in compelling cases in which quantification of the private nonlitigation benefits is easy and there is no social detriment associated with these benefits, a court should ignore private nonlitigation benefits in determining the value of the claim.

In the second step, the court should assess the costs of resolving the litigation. This assessment begins with the parties' proposed budgets and with their positions (agreement or dissent) with respect to the budget(s) filed by their opponent(s). As a rule, the judge must accept the costs provided on each party's budget; the judge may, however, strike glaringly needless and costly budget items to which an opponent objects.[161] After determining these private costs, the court should add the estimated cost of judicial resources necessary to resolve the dispute.

In the third step, the court compares the private benefits of the lawsuit to the costs of resolving it. If the benefits exceed these costs, then the court must presumptively approve the budgets, regardless of the parties' consent or opposition to one another's budgets. If the private costs exceed the private benefits, then the court must presumptively trim the budgets to a point at which the costs and benefits come into balance.

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159. *See* 28 U.S.C. § 620(b)(1) (2012) (providing that one function of the Federal Judicial Center is "to conduct research and study of the operation of the courts of the United States, and to stimulate and coordinate such research and study on the part of other public and private persons and agencies"). At present, the Administrative Office of the United States Courts also collects basic data on federal cases, including by nature of suit. Civil suits are divided into the following categories: contract, real property, tort, civil rights, various prisoner and detainee petitions, forfeiture and penalty actions, labor suits, Social Security actions, and others. *See* ADMIN. OFFICE OF THE U.S. COURTS, JUDICIAL BUSINESS OF THE U.S. COURTS, tbl.C-3 (2013), http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2013/appendices/C03Sep13.pdf, *archived at* http://perma.cc/8NZQ-QH33.

160. *See supra* notes 32–33 and accompanying text.

161. Thus, the parties' consent or opposition to items contained in an opponent's proposed budget is relevant only to the extent that opposition reveals an egregious expense that a court is justified in striking. On the larger role that consent or opposition plays in the British system, see *supra* note 116 and accompanying text.

In the fourth and final step, a party can seek to overcome the presumption. If the presumption favors approval (in other words, the benefits obtained from the case exceed the costs of resolving it), a party may seek to prove that the case involves public costs that, when added to the private costs of the litigation, tip the case from one involving a net social benefit to one involving a net social loss, thus requiring the court to trim the budgets.[162] Courts should not readily accede to parties' arguments about including alleged public costs. In the first place, the public costs of litigation are difficult to quantify. Moreover, arguments about the public costs of litigation may be a thinly masked effort to argue that either a legal rule or its application to the case is unwise. The court should turn a deaf ear to these arguments: When lawmakers create a right, the court should presume that its full enforcement is a public benefit. Legitimate concerns about the law's application should already be accounted for in the case's probability of success.

Nonetheless, in rare cases a public loss may be easily quantified and is not merely a proxy argument about the value of enforcing the law. For example, a defendant may show that it has already provided much of the requested relief in *parens patriae* or similar actions, so that the compensation requested in the present suit would lead to excessive deterrence.[163] In these cases a court may add the public costs of litigation to the private costs reflected on the parties' budgets to determine the overall social cost of the lawsuit.[164]

If the total social cost now outweighs the private gain, the court must allow the opposing party to prove that the case has value to the public that extends beyond the private gain to that party—and that this public value tips the scales in favor of approving the budgets. As with

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162. If a case involves social losses but they are less than the net private gain from the lawsuit, then the case is still a net gain, and the budgets should be approved. On the trimming of budgets, see *infra* note 167 and accompanying text.

163. On the use of *parens patriae* and agency settlements to provide relief, see Margaret H. Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, 126 HARV. L. REV. 486, 511–30 (2012); Adam S. Zimmerman, *Distributing Justice*, 86 N.Y.U. L. REV. 500, 520–39 (2011).

164. To take an example, in *Iqbal* the Supreme Court imposed heightened pleading in part because of the social loss (in terms of reduced governmental efficiency) that lawsuits against government officials imposes. *See* Ashcroft v. Iqbal, 556 U.S. 662, 685 (2009) ("Litigation, although necessary to ensure that officials comply with the law, exacts heavy costs in terms of efficiency and expenditure of valuable time and resources that might otherwise be directed to the proper execution of the work of the government."); *cf.* Harlow v. Fitzgerald, 457 U.S. 800, 816 (1982) (noting that lawsuits against officials impose the "general costs of subjecting officials to the risks of trial—distraction of officials from their governmental duties, inhibition of discretionary action, and deterrence of able people from public service"). Such a social loss would qualify for consideration in setting the budget but only if a party could quantify the size of the loss. General claims of social loss must be ignored.

public losses, any party arguing for the inclusion of public benefits must be able to quantify the benefit; generic arguments about the benefit of enforcing the law will not do. For instance, the lawsuit may involve a constitutional or public-law right, the vindication of which has great public value but modest private value.[165] In the language of proportionality, "the importance of the issues at stake in the action"[166] may lead a court to decide that the combination of the private and public benefits of a case exceeds the combination of its private and public costs, even when the private benefit alone does not.

Conversely, if the presumption favors trimming the parties' budgets, a party may seek to overcome the presumption by showing that the public benefits of the case, when combined with the private benefits, exceed the private costs. For instance, a lawsuit may be the first in a series of mass torts or mass consumer disputes, for which the start-up costs are necessarily high in relation to the value of the plaintiff's case. When spread across all of the later cases that will benefit from the lawsuit's pathbreaking work, however, the costs are reasonable. If the quantifiable public benefits overcome the presumption calculus, the opposing party may then argue that the court should consider quantifiable public costs in establishing a proper budget.

In balancing benefits and costs, the court's only role is to ensure that the expected private and public costs of litigation are less than its private and public gains, not to tweak and trim the budgets to achieve the greatest social benefit. The purpose of litigation budgets is to ensure that the benefits of litigation exceed the costs. As long as this condition is met, further judicial intervention in the parties' expenditures is unwarranted; the amounts that parties spend on the lawsuit are their own business.

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165. Because of the difficulty of quantifying constitutional rights, a court might appropriately exempt structural-reform and other public-law litigation seeking injunctive relief from the operation of the litigation-budgeting process. The private value of a constitutional right (for instance, the right not to say a Christian prayer in a public school) may be difficult to discern; so, for that matter, is the social value of ensuring governmental compliance with fundamental constitutional norms. *Cf.* DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES 181–87 (4th ed. 2010) (discussing the difficulty of valuing constitutional rights). Moreover, structural-reform cases rarely involve the type of cost issues that drive the arguments for litigation budgeting; the lawyers who typically represent plaintiffs in such institutional-reform cases and the government's lawyers are salaried workers with large case dockets and so typically have reason to handle the litigation as expeditiously as possible. Of course, the statements in the prior sentence are generalizations, so in proper circumstances a court may nonetheless impose litigation budgets on parties in structural-reform and other similar public-law litigation. But general exemption of these cases from the litigation-budgeting process removes one of the most potent criticisms of budgeting ("Courts can't value the social benefits of litigation.") in the group of cases in which that criticism has its greatest salience.

166. FED. R. CIV. P. 26(b)(2)(C)(iii).

In a substantial number of cases, expected benefits will exceed expected costs,[167] so the court's principal task will be to ensure that the parties live within their budgets. In some cases, however, the court will find that the expected social costs of litigation exceed the expected social benefits. Here the court must generally trim the parties' budgets. If the balance of benefit and cost is close, the court may nonetheless approve the budgets if both parties consent to one another's budgets: the court must be mindful of the limits of its knowledge about the case. But otherwise the court must reduce the parties' budgets to appropriate levels. In deciding the amount to trim, the court should consider the public importance of the litigation, as well as the likely value of discovery, pretrial motions, and other litigation activities in resolving the dispute. It should also apply any cuts in an even-handed way, although fairness might not be a simple matter of pro rata cuts to both sides' budgets. The court may believe that only one side padded its budget and extract all the necessary cuts from that side. The court may cut back on only certain line items. The court may leave the consented-to portions of the budgets untouched, or it may look to these portions for savings. Whatever the approach, the court's goal is to bring the social gains from a lawsuit in line with its costs. Over time, as judicial experience with litigation budgets develops and empirical data help courts to refine their analyses, best practices should make the task of trimming simpler.

Thus, although the factors in the litigation-budgeting process are essentially the same as those under the proportionality analysis of Rule 26, their application is not as open-ended. "The needs of the case" and "the amount in controversy," properly understood to refer to a comparison of the expected private benefits and expected private and judicial costs in resolving the case, are the baseline factors in all cases. But when private gains exceed private and judicial costs, the proportionality inquiry ends, and the court's only job is to keep the parties within their budgets. "The importance of the issues at stake in the action" can tip a case from one in which the court must reduce the budget (because private and public losses exceed private gains) to one in which the court approves the budget (because private plus public gains exceed private plus public losses). "The importance of [the pretrial and trial measures] in resolving the issues" helps a court, along with

167. After reviewing studies about the costs of the tort system, Professors Polinsky and Shavell concluded "that, for each dollar that an accident victim receives in a settlement or judgment, it is reasonable to assume that a dollar of legal and administrative expenses is incurred." Polinsky & Shavell, *supra* note 36, at 1470. If the average case is one in which recovery and costs are evenly balanced, a substantial number of cases should lead to judicial approval of the parties' budgets.

other factors, to decide how much to trim the parties' budgets when losses exceed gains.[168]

Throughout this process, but particularly when it must intervene to limit the parties' budgets, the risk of judicial error exists. Two factors offset this risk. First, on a large scale, errors may wash out; even if courts sometimes allow budgets that are too large and other times allow budgets that are too small, spending on litigation should come close to hitting the socially appropriate mark as long as judges as a whole are not systematically overvaluing plaintiffs' prospects (or conversely, systematically undervaluing them).

This perspective is cold comfort to individuals in cases in which errors are made, but a second factor can limit case-by-case mistakes. As a case progresses, a party can seek a revision of the initial budget. If the evidence obtained in discovery reveals that the claim is stronger than it originally appeared, the court may revise the budget upward. If the case appears weaker and if the court would now be justified in trimming the parties' budgets in accordance with the principles just described, the court can revise the budget downward.[169]

B. Objection Two: Practical Problems in Implementing Litigation Budgets

Aside from the practical difficulty of approving proper budgets, a court faces other practical challenges. Here I highlight two: the problem of determining fees—both contingent and hourly—for legal work and the likelihood of gamesmanship in a litigation-budgeting system.

168. The only present proportionality factor that this analysis does not directly include is "the parties' resources." FED. R. CIV. P. 26(b)(2)(C)(iii). The point of litigation budgeting is to ensure the cost-effective expenditure of the parties' resources. Insofar as the "parties' resources" is a reference to the parties' relative wealth, litigation budgeting ignores this consideration.

169. To avoid gamesmanship in the processes of setting and amending budgets, an amendment of the court's original budget should require a strong showing (perhaps equivalent to the manifest-injustice standard of Rule 16(e)). Consistent with the review of trial courts' other case-management powers, the appellate standard for reviewing the court's decisions regarding budgets should be abuse of discretion. *See*, *e.g.*, *In re* Bayer Healthcare & Merial Ltd. Flea Control Prods. Mktg. & Sales Practices Litig., 752 F.3d 1065, 1072 (6th Cir. 2014) ("This court 'typically review[s] a district court's case-management decision made pursuant to Rule 16 for abuse of discretion.' " (quoting Miller v. Am. Heavy Lift Shipping, 231 F.3d 242, 252 (6th Cir. 2000))); ZF Meritor, LLC v. Eaton Corp., 696 F.3d 254, 268 (3d Cir. 2012) ("We . . . review a district court's decisions regarding discovery and case management for abuse of discretion.").

1. Budgets and Fees

A major cost of litigation is attorney's fees. In setting limits on the amount to be paid for pleading, discovery, motions, negotiations, trial, and the like, the number of hours or the fee that a lawyer charges inevitably weigh on a court. One of the most objectionable aspects of litigation budgeting is the apparent control that the court now exercises over attorney's fees. This objection comes in two forms: first, that judges should not establish rates that lawyers can be paid; and second, that a litigation-budget system cannot work with contingent fees.

a. The Hourly Fee. The judge's influence over attorney's fees is limited but consequential. Assume that the defendant submits a budget with a line-item limit of $100,000 for conducting affirmative discovery. In setting this line item, an attorney paid by the hour is likely to determine the number of hours that it will take to complete the task (say, 250) and multiply it by the lawyer's rate (say, $300 per hour), and then add to this total ($75,000) the remaining expenses like travel, expert witnesses, and court reporters (say, $25,000). If the parties' budgets, plus the court's own costs, amount to less than the gains of the case, the judge approves the budget. The size of the fee is never the judge's business. The judge's only obligation is to ensure that the client pays no more than $100,000 for the case.

When the combination of the parties' proposed budgets and judicial costs exceeds the social value of the case, however, the judge more actively manages costs. When faced with the proposed line item of $100,000 to conduct discovery, the judge will consider the same cost components: the fee for the attorney and the expenses for travel and the like. The judge will almost certainly determine a proper charge for the lawyer by calculating the number of hours that an attorney should reasonably work to accomplish discovery and multiplying those hours by a reasonable hourly rate. Assume that the judge believes that 200 hours for discovery are sufficient and $250 is a reasonable hourly rate. After determining that $50,000 is a proper fee, the judge will then add in other expenses and fees. If we assume that these fees remain constant at $25,000, the judge will approve a budget of $75,000 for the party to conduct discovery.

That said, the judge does not directly control the lawyer's hours or hourly rate. The lawyer need not work 200 hours or charge $250 per hour. The lawyer who scrimps on expenses and stays at Motel 6 may still be able to charge $300 per hour. The lawyer may conduct only 125 hours of discovery and charge $400 per hour. Or the lawyer may work more hours (say, 400) and charge less per hour (say, $125). The client's obligation is to pay $75,000 for the task of conducting discovery; the

lawyer figures out how to keep the client's representation within that limit.

Nevertheless, the judge's influence over hourly rates is undeniable. Lawyers must set hours and rates for various tasks with an eye toward what a judge will approve. Many lawyers who charge higher fees will feel particularly aggrieved by budget setting. In some cases, higher fees may be a reflection of the lawyer's expertise and efficiency; to the extent that this is true, the lawyer needs to work fewer hours, and the matter will wash out. But higher fees may also be a reflection of higher overhead costs or of quality independent of expertise; and a judge should not interfere, the argument goes, in the relationship between a client willing to spend the money and a lawyer worth the price. Limiting the budget to $50,000 means that these lawyers will be able to work fewer hours than their lower-rate opponent (thus limiting their effectiveness in serving their clients), or that they will need to cut their fees. In either event, the standard of legal practice will fall into mediocrity; if the judge believes that a reasonable rate is $300 per hour, there is little incentive for lawyers to excel in ways that would justify a higher fee. Furthermore, the power to limit costs could have a substantial dislocating effect, as lawyers with offices in midtown Manhattan found themselves at a competitive disadvantage with firms on midwestern Main Streets.[170]

An apparent compromise is to give a judge the power to limit the hours that lawyers may work but to allow the lawyers to bill at whatever rate the market bears. The difficulty of this compromise is that it does not address adequately the principal point of litigation budgeting: the direct control of litigation costs, of which attorney's fees are a major driver. Moreover, limiting hours rather than fees is feckless. Judges possess familiarity with the rates of law firms from their decisions in fee-shifting cases[171] and in imposing sanctions;[172] if lawyers are required to fill out a form equivalent to the English Precedent H, they will also need to list their hourly rate for each pretrial and trial

170. It could also have a different dislocating effect, as lawyers at multi-service firms raise rates on a client's nonlitigation work to compensate for reductions in litigation rates. Whether clients would pay above-market rates for transactional work in a wink-and-nod arrangement to keep litigation rates artificially low is doubtful, as long as other firms are willing to work for market rates.

171. *See supra* note 15 (describing fee-shifting statutes).

172. *See*, *e.g.*, FED. R. CIV. P. 11(c)(4) (permitting a court to award "all of the reasonable attorney's fees and other expenses" in responding to a Rule 11 violation); FED. R. CIV. P. 37(a)(5)(A) (permitting a court in some situations to award a litigant who moves for a motion to compel discovery "reasonable expenses incurred in making the motion, including attorney's fees").

task in their budgets.[173] Knowing the number that they need to make the budget work (say, $75,000 for the defendant's conducting of discovery), judges would use their knowledge of hourly rates to reverse engineer the number of hours a lawyer can work.

Without question, the potential chill on the quality of lawyering is a troublesome feature of litigation budgeting. A solution that rewards quality lawyering is to allow a judge, at the end of a case, to award a modest enhancement to the attorney's fees when the judge sees exceptional skill—lawyering that meets the highest standard of professionalism, that is civil and cost-effective, and that yields greater benefits for a client than the judge anticipated. Unlike the present fee structure, in which higher fees are often based on past performance or firm reputation, this enhancement is earned for work in the present case. The judge should grant an enhancement—whose possibility should be communicated to clients at the outset—only in an exceptional case and only sua sponte; for obvious reasons, lawyers should not be allowed to petition the court for an enhancement.[174]

Given its inevitable effect on attorney's fees, litigation budgeting may lose its luster for many. But it is important to recall why it is necessary to impose limits that have an impact on hourly rates. Certain cases cost too much to litigate. In the cases that do not, litigation budgeting imposes no limits on the ability of lawyers to charge whatever rates their clients are willing to pay; and the kinds of disputes for which high-fee firms are typically employed—major antitrust violations, securities-fraud claims, class actions, and multidistrict mass torts—often involve sums of money so large that they fall into this category. For those cases in which fees drive up costs to the point that the costs exceed the social value of the lawsuit, however, the lawyer's desire to work an unrestricted number of hours while charging an unrestricted rate must give way to society's needs to use precious judicial resources in a cost-effective way. As we have seen, clients will pay excessively for litigation in two scenarios: when they rationally expect private gains to exceed private costs and when they irrationally have the same expectation.[175] When the client's willingness to overspend on litigation does not rationally advance its interests, the lawyer's ethical responsibility is to help the client come to a rational

173. *See* Precedent H, *supra* note 114, at 2–5 (including a column requiring lawyers to list their hourly rates with respect to various tasks such as investigation, pleading, disclosure, trial and settlement).

174. Granting an enhancement for quality lawyering may prove unduly problematic in states with an elected judiciary, for enhancements may too readily appear to be kickbacks to lawyers who provided campaign donations or other support during the judge's election.

175. *See supra* Parts II.A.1, II.B.1.

decision about litigation spending, not to bill unlimited hours at unrestricted rates to placate the client's irrationality. When the client's decision to overspend is rational, the lawyer has obligations not only to the client but also to the court to ensure the fair and efficient administration of justice.[176]

Litigation budgeting does not allow judges to set hourly fees directly. But it has an undeniable influence over the rates that litigators can charge—an influence that is necessary "because that's where the money is."[177] Any costs-management reform that fails to address the impact of unrestricted attorney's fees and unlimited attorney hours on litigation costs is bound to fail. The litigation budget's influence over rates is something of a litmus test for anyone interested in enacting reforms to control the costs of modern American litigation. If litigation budgeting seems a bridge too far, then we should give up the pretense that we are serious about cutting the cost of civil litigation.

b. The Contingent Fee. A different problem arises for contingency fees, which are commonly used by plaintiff's lawyers in tort litigation.[178] Because the lawyer is not guaranteed payment, the fee includes a risk premium: if successful, the lawyer is likely to earn more for the case than he would have earned had he charged by the hour.[179]

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176. *See*, *e.g.*, McBryde v. Comm. to Review Circuit Council Conduct & Disability Orders of the Judicial Conference of the U.S., 264 F.3d 52, 78 (D.C. Cir. 2001) ("[L]awyers serve both as zealous representatives of their clients and as officers of the court with responsibilities for fairness and disclosure that transcend their clients' interests."). Moreover, lawyers possess an ethical responsibility not to overcharge their clients. *See* MODEL RULES OF PROF'L CONDUCT R. 1.5(a) (2013) ("A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses."). The factors typically considered in a fair fee—including the lawyer's time, the novelty and difficulty of the issues, the lawyer's skill, the customary fee changed in the locality, and "the experience, reputation, and ability of the lawyer"—are not different than those a court should consider in the costs-budget process. *See id*. The problem is that, despite this professional admonition to keep fees within bounds, "there appears to have been very little effort to apply it." Stephen D. Annand & Roberta F. Green, *Legislative and Judicial Controls of Contingency Fees in Tort Cases*, 99 W. VA. L. REV. 81, 82 (1996).

177. This answer was reportedly given by Willie Sutton when he was asked why he robbed banks, although Sutton denied that he ever made the statement. *See* WILLIE SUTTON, WHERE THE MONEY WAS: THE MEMOIRS OF A BANK ROBBER 120 (1976). The answer has given rise to "Sutton's Law": to look first in obvious places for a solution. *See* David S. Prince, *Sutton's Law and Economics Applied to the Professional Fiduciary: Helping the Trustee Avoid Predatory Litigants*, 119 BANKING L.J. 17, 17 (2002). The most obvious place to look for a solution to excessive litigation costs is attorney's fees.

178. Contingency-fee arrangements are not limited to tort cases, although they are "essentially prohibited" in areas like divorce and criminal work. *See* MODEL RULES OF PROF'L CONDUCT R. 1.5(d) (2013); *see also* Lester Brickman, *Contingent Fees Without Contingencies: Hamlet Without the Prince of Denmark?*, 37 UCLA L. REV. 29, 35–42 (1989) (describing the historical development of and remaining prohibitions on contingency fees).

179. *See* Brickman, *supra* note 178, at 31–32 (arguing that some contingency fees are unethical because "the contingent fee far exceeds any legitimate risk premium for the anticipated effort").

One of the difficulties of litigation budgeting is its capacity to account for this risk premium, whose payment advances the social interest of increasing access to courts and legal representation for those of modest means.[180] Trying to value this interest in determining an appropriate budget is a daunting challenge. Assume that the court calculates the expected recovery at $60,000. Thus, a standard one-third contingency fee yields an expected fee of $20,000. Some portion of that fee is for the work in this case; some is to compensate for the risk of nonpayment in this and other cases. Because the social good is advanced by the lawyer's willingness to take on this risk, the court should not treat the latter portion of the fee as a cost in this case for purposes of litigation budgeting. But how is a court to know what is the correct portion of the fee to charge against this case when assessing the size of the plaintiff's budget?[181]

One solution is to exempt all contingency-fee cases from litigation budgeting. But that idea is unappealing, for litigation budgeting will exercise an outsized influence in driving lawyers toward contingent fees. Contingency-fee cases also constitute a significant portion of all litigation.[182] If we are serious about reducing costs, it would be unwise to ignore such a large swath of cases—at least if there is a workable alternative.

The other realistic option is to reform the contingency fee.[183] Courts should determine the plaintiff's lawyer's fee on the basis of two

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180. *See id.* at 43–44 (stating that "contingent fees encourage litigation, thereby furthering the national policy in favor of increasing access to courts" and "further promote access to the legal process by encouraging less risk-averse lawyers with larger practices to accept cases that might otherwise go unrepresented because of the risk of non-recovery and the client's inability to pay an hourly or fixed fee").

181. In a sense, this question is a specific application of the problem that courts face when determining how to value the social benefit of a lawsuit. *See supra* notes 160–61 and accompanying text (stating courts should generally ignore private nonlitigation benefits when assessing a claim's value).

182. Approximately 23.8 percent of federal cases commenced in fiscal-year 2013 were tort cases (67,738 tort out of 284,604 total). *See* ADMIN. OFFICE OF THE U.S. COURTS, *supra* note 159, tbl.C–2A, at 1, www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2013/appendices/C02ASep13.pdf, *archived at* http://perma.cc/8ZNV-2YN2. Although the mix of litigation in federal court is not identical to that in state court, and although tort cases are not synonymous with contingency-fee cases, this percentage provides a very crude estimate of the scope of contingency-fee litigation.

183. Another option is to limit not the fee charged but the hours that contingency-fee lawyers may work—on the theory that working fewer hours will reduce the size of the judgment or settlement and thus keep the costs of the contingency fee down. The judge could calculate the hours that the contingency-fee lawyer should put into each task by taking an appropriate total charge for the attorney's work for each aspect of the case and dividing by an appropriate hourly rate; the judge could then restrict the lawyer to working only these hours. This approach however, is unsatisfactory. Given that the client wants the lawyer to work more hours and the lawyer wants to earn a higher fee, there is no effective way to monitor that the lawyer limits his hours—while

components: first, hours worked for different tasks times a reasonable hourly fee; and second, a percentage of the ultimate recovery. The former component compensates the lawyer for his time on the case; it constitutes the amount that is chargeable as an expense in the present case. The latter component contains the risk premium; it compensates the lawyer for the socially valuable risk that he took on in accepting the case.

On this approach, the contingency-fee lawyer, like the defense lawyer, must prepare the plaintiff's litigation budget by specifying the hours to be worked on each line-item task (investigation, pleading, discovery, trial, and so on) and the appropriate hourly fee for each task. On the basis of the principles that I have discussed, the judge must either accept the plaintiff's budget or reduce it to a level that keeps costs within acceptable boundaries.[184] The case then proceeds to its conclusion. If the plaintiff receives nothing, the lawyer receives no fee. If the case yields a positive recovery, the judge totes up the approved fees on the litigation budget for each task that the contingency-fee lawyer ultimately performed. This number becomes the plaintiff's lawyer's base award. The court then enhances the base award by an appropriate percentage of the recovery and adds it to the base fee. The size of the enhancement should reflect social value of taking on a risky case; the value of the lawyer's services in the present case are accounted for in the base award.[185] In effect, the court awards a fee on something akin to a lodestar basis.[186]

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the hourly-fee defense lawyer on the other side of the case is handcuffed to work only the prescribed number of hours. Nor do limitations on the hours worked necessarily correlate with the size of the fee; as we have seen, limiting hours rather than fees is a poor way to control costs. *See supra* notes 171–73 and accompanying text.

184. *See supra* Part IV.A.

185. Given that the incentive to assure access to courts is a principal component of the social value of contingency fees, a critical factor in determining the appropriate risk-premium percentage is the degree of risk that the lawyer took on in accepting the case. *Cf.* Brickman, *supra* note 178, at 94–99 (advocating the use of contingency fees that are calibrated to the degree of risk the case presents). In rare cases, an additional amount may be awarded for superb representation. *Cf. supra* note 174 and accompanying text (permitting a rare enhancement of the hourly fee to account for exceptional representation).

186. The lodestar approach multiplies the hours that class counsel reasonably expended by the prevailing hourly rate; the court can then adjust this award upward or downward depending on the quality of representation, the degree of success, the risk associated with the litigation, the complexity of the case, and other factors. *See In re* Diet Drugs (Phentermine/Fenfluramine/Dexfenfluramine) Prod. Liab. Litig., 582 F.3d 524, 541 (3d Cir. 2009) (listing ten factors in determining a fee award). Lodestars are often used to award attorney's fees under fee-shifting statutes. *See* Blum v. Stenson, 465 U.S. 886, 895 (1984) (holding that "'reasonable fees' under § 1988 are to be calculated according to the prevailing market rates in the relevant community"); Hensley v. Eckerhart, 461 U.S. 424, 433 (1983) ("The most useful starting point for determining the amount of a reasonable fee is the number of hours reasonably expended on the litigation multiplied by a reasonable hourly rate."); Fischel v. Equitable Life Assurance Soc'y of the U.S., 307

The court's role in overseeing contingency fees is different than it is with respect to lawyers paid by the hour in two regards. First, with hourly fee lawyers the court's role in setting fees is indirect; the court approves a maximum amount that the client is obligated to pay the lawyer for performing certain litigation tasks but does not set the fee.[187] In the contingency area, however, the court directly determines the risk-premium portion of the fee. Second, with hourly fee lawyers the court has no power to limit hourly fees or expenditures when the private gains from litigation exceed the total costs; its power to limit costs arises only in cases in which the budgets suggest that the costs of litigation exceed the gains of the lawsuit.[188] In the contingency area, in contrast, the court must determine the proper percentage of the recovery to award even in cases in which the private gains exceed the costs.

The reason is that, without such a constraint, the contingency-fee lawyer is free to work many more hours than the hourly fee lawyer representing the defendant, creating an unfair imbalance in the litigation. For example, assume that the case involves horrific injuries and is worth an expected $3 million. The plaintiff's lawyer thus stands to gain $1 million from the case on a standard one-third contingency. But the facts of the case are fairly simple, and the liability clear. The plaintiff's budget reflects that the plaintiff's lawyer expects to put in 500 hours on the case, and the reasonable hourly charge for his services is $300 per hour. In addition, other litigation expenses (i.e., expert witnesses and the like) amount to $50,000. Thus, on the plaintiff's side, expenses are $200,000. The defense has similar expenses, and the court's time to resolve the dispute is $50,000. The $450,000 in total expected costs is considerably less than the expected recovery of $3 million.

On these facts, the $850,000 differential between the contingency award ($1 million) and the value of the work performed

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F.3d 997, 1006 (9th Cir. 2002) ("In a common fund case, the district court has discretion to apply either the lodestar method or the percentage-of-the-fund method in calculating a fee award."); *cf.* McDaniel v. Cnty. of Schenectady, 595 F.3d 411, 417–19 (2d Cir. 2010) (noting the trend toward the percentage-of-the-fund approach in common-fund cases, but upholding the use of a lodestar approach).

The costs-budget approach varies from a traditional lodestar in modest ways. First, it enhances the award on a percentage-of-recovery basis, which is a common, but not the only, method for calculating the lodestar. Second, the factors that determine the appropriate percentage focus on the social value of the lawyer's representation, and are therefore somewhat different from the factors presently used to calculate lodestars. Finally, in theory a lodestar is not capped by the size of the plaintiff's recovery (i.e., the plaintiff could end up paying a larger fee than the benefit received), although in practice it is likely to be. Under the approach I describe, this cap is automatic.

187. *See supra* Part IV.B.1.a.

188. *See supra* Part IV.B.1.a.

($150,000) excessively compensates the plaintiff's lawyer for the risk of taking on the case. But the real difficulty is that, unless the plaintiff's lawyer is limited to a $150,000 base fee plus a risk-compensating percentage of the ultimate award, the lawyer may have an incentive to work far more than 500 hours. As long as an additional hour of work will yield more than an additional $300 in fees (in other words, will raise the value of the case by more than $900[189]), the contingency-fee lawyer has an incentive to do so. Moreover, the plaintiff is pleased to allow the lawyer to work the additional hours, so there is no effective monitor that limits the hours that the plaintiff's lawyer may work. The defense, however, is handcuffed. Paid by the hour, defense counsel cannot receive compensation for the additional hours that might be necessary to respond to the plaintiff's lawyer's efforts without obtaining a budget revision.

An important side effect of this change to the standard contingency fee is that it aligns the incentives of the plaintiff and counsel. This hourly-plus-percentage-of-the-recovery fee was first proposed by Kevin Clermont and John Currivan. Their seminal work demonstrates how this structure avoids agency-cost problems typically arising with traditional contingency fees or hourly fees.[190] This side benefit enhances the desirability of using a litigation-budgeting process, although it is not the principal argument for doing so.

The evident problem with modifying contingency fees is the involvement of courts—in thousands upon thousands of cases—in the difficult business of setting appropriate contingency fees. This new judicial role may lead some critics to believe that the better option is to exempt contingency-fee cases from litigation budgeting. But the existence of litigation budgets considerably lessens the difficulty of setting fees; the budget establishes the base fee that the lawyer has earned, and the court will have a good sense of the actual risk that the lawyer took on when it sets the proper percentage. With time and experience, the process of setting fees will become simpler. Whatever its drawbacks, judicial fee-setting in contingency-fee cases is essential

189. I assume a standard contingency fee, in which the lawyer receives one-third of any recovery. Thus, to garner an additional $300 in fees, the value of the case must increase by $900.

190. *See* Clermont & Currivan, *supra* note 93, at 546–50. Under this plan, the amount of the fee would ultimately be capped by the size of the plaintiff's recovery. *Id.* at 546–47. Their proposal mentions, and subsequent work based on the proposal emphasizes, the importance of using the plaintiff's net recovery (gross recovery less nonfee expenses) when calculating the appropriate risk-premium percentage. *See id.* at 557–58; Jay Tidmarsh, Cy Pres *and the Optimal Class Action*, 82 GEO. WASH. L. REV. 767, 788 (2014) ("[W]hen calculating the percentage-of-the-fund portion of the fee, the court must use the net recovery to the class, rather than the gross recovery, as the fund of which counsel may receive a percentage.").

if a litigation-budgeting process and, more generally, control of litigation costs are to be successful.

2. Gamesmanship

In an adversarial system, any rule is likely to be used in unintended ways. Litigation budgeting is not immune to the problem. Each side will adopt strategies in setting their original budgets that seek to minimize the other side's access to litigation resources and maximize their own. In conducting litigation, each side will have an incentive to act in ways that exhaust the other side's budget while holding on to as much of their own as possible. Litigation could become a battle in which victory goes to the party with the last dollar to spend.

Of course, in some sense this reality is already true; litigation budgeting shifts the tactics but not the goal of exhausting your opponent's resources before your own. In a litigation-budget world, courts must be especially vigilant about stonewalling and document-dump tactics that could eat up substantial portions of an opponent's resources.[191] Sanctions that punish such behavior by reducing an offending party's own budget are necessary, but, as I have explained, sanctions that are effective in preventing wasteful obstreperous behavior are also at hand.[192] These sanctions, however, also create a new opportunity for satellite litigation designed to exhaust an opponent.[193]

Indeed, the line-item nature of the litigation budgets is likely to decrease some forms of gamesmanship. Parties will not be able to spend more than a determined amount on each phase of the litigation. As a case moves to a new phase (say from pleading to discovery, or from discovery to dispositive motions to trial), new resources become available. It would no longer be possible, as it is now, to spend an opponent out of court just during the discovery phase of the case.

Nonetheless, it would be Pollyannaish to suggest that litigation budgeting will have no untoward effects on the conduct of litigation. Despite this reality, the purpose of the system—to keep litigation costs within manageable bounds—must be kept in focus. The complaints about the expense of modern litigation are legion. Parties are exiting

191. *See supra* notes 149–50 and accompanying text.

192. For some potential uses of this sanctioning power, see *supra* note 150 and accompanying text.

193. *See* Georgene Vairo, *Rule 11 and the Profession*, 67 FORDHAM L. REV. 589, 625–26 & nn. 258–60 (1998) (stating that there had been only nineteen reported decisions under Rule 11 before the strengthening of its sanctions in 1983, while 6,947 reported cases had cited Rule 11 between 1983 and June 1993).

litigation to resolve disputes through settlement, mediation, and arbitration in no small measure because litigation is too costly.[194] If litigation is to survive and thrive in the marketplace of dispute-resolution alternatives, it must adapt and become less costly. Other strategies have proven ineffective. Litigation budgeting creates opportunities for gamesmanship and thus requires policing. In cases in which the court limits budgets, more policing may mean more reductions in the parties' own budgets. In this sense, a litigation-budget world gives the parties more incentive to cooperate and to reserve their disputes to issues that matter.

C. Objection Three: The Court's Authority

Regulating the amount of money that parties expend on litigation constitutes a significant change in American litigation—one that raises issues of judicial power. Except in class actions[195] and cases that involve fee shifting,[196] courts have been reluctant to involve themselves in setting lawyers' fees and regulating other litigation expenses. Whether they lack the power to do so is a different matter.

1. Rulemaking Issues

The first question is whether courts possess the rulemaking authority to promulgate litigation-budget rules. In federal court, the Rules Enabling Act authorizes the Supreme Court to "prescribe general rules of practice and procedure,"[197] but only if these rules do "not abridge, enlarge or modify any substantive right."[198] The Court has interpreted the Rules Enabling Act to provide a broad power to

194. *See* Alexander A. Reinert, *The Burdens of Pleading*, 162 U. PA. L. REV. 1767, 1777–78 (2014) ("Merchants may view arbitration as cheaper, faster, and less transparent than litigation."); Note, *Mediation of Investor-State Conflicts*, 127 HARV. L. REV. 2543, 2551 (2014) ("Starting in the 1970s, a 'corporate-consumer revolution against litigation costs' led in-house counsel to consider alternative dispute resolution (ADR), and especially mediation, for resolving business disputes." (citing Ellen Joan Pollock, *The Alternate Route*, AM. LAW., Sept. 1983, at 70)).

195. *See* FED. R. CIV. P. 23(h) ("In a certified class action, the court may award reasonable attorney's fees and nontaxable costs that are authorized by law or by the parties' agreement."). Courts have tended to compensate counsel either by awarding fees for hours worked (the lodestar approach, in which the court may enhance the market rate by a multiplier if the case is highly successful) or by awarding a percentage of the recovery. *See* Goldberger v. Integrated Res., Inc., 209 F.3d 43, 50 (2d Cir. 2000) (holding that a court has discretion to calculate class counsel's fee on either a lodestar or a percentage basis).

196. *See supra* note 15 (discussing fee shifting in American courts).

197. 28 U.S.C. § 2072(a) (2012).

198. *Id.* § 2072(b).

promulgate procedural rules even when they have "incidental effects" on substantive rights.[199]

Nevertheless, it is doubtful that litigation budgets fall within the Supreme Court's power. In the United Kingdom, the Civil Procedure Rule Committee promulgated the costs-budget system without Parliamentary approval, but extensive preexisting provisions regarding cost shifting and the integration of costs budgeting into those provisions make British costs budgeting seem a less "substantive" and more "procedural" matter than litigation budgeting would be in the United States.[200] The regulation of attorney's fees, especially the change in contingency fees, suggests strongly that the effects of a litigation-budget system on substantive rights are not "incidental." Therefore, costs budgeting likely exceeds the scope of rulemaking under the Rules Enabling Act. Adopting costs budgeting in the federal courts requires congressional authorization.

Wending such a system through a political as opposed to a rulemaking process presents substantial practical challenges that affect the prospects for adoption of litigation budgeting. Lawmakers must be satisfied about the wisdom of the policy goal of preventing socially wasteful litigation practices, as well as about the wisdom of litigation budgeting as a means to achieve that goal. I return to this practical point in the Conclusion, after considering other legal impediments to budgeting.

2. Constitutional Concerns

Litigation budgeting brings into play a number of constitutional provisions, such as the right to jury trial[201] or state open-courts or right-

199. *See* Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co., 559 U.S. 393, 407 (2010) (plurality opinion) (stating that the Enabling Act's "limitation means that [a Federal] Rule must 'really regulat[e] procedure,—the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or infraction of them' " (quoting Sibbach v. Wilson & Co., 312 U.S. 1, 14 (1941))); Bus. Guides, Inc. v. Chromatic Commc'ns Enters., Inc., 498 U.S. 533, 553–54 (1991) ("[T]he Rules Enabling Act is not violated by . . . incidental effects on substantive rights."). Whether the Court has correctly interpreted the breadth of its rulemaking power is frequent fodder for academic debate. *See*, *e.g.*, Jay Tidmarsh, Foreword, Erie's *Gift*, 44 AKRON L. REV. 897 (2011) (discussing how *Shady Grove* will affect the definition of substantive and procedural rights under the Rules Enabling Act and *Erie*).

200. The award of costs was already the subject of detailed regulation in Parts 44–48 of the Civil Procedure Rules. *See* SIME, *supra* note 116, § 46.01–47.15 (describing the system for awarding costs).

201. For the federal right to a civil jury trial, see U.S. CONST. amend. VII. All but two American states (Louisiana and Wyoming) have jury-trial rights of similar or greater breadth. Robert Wilson, Note, *Free Speech v. Trial by Jury: The Role of the Jury in the* Pickering *Test*, 18 GEO. MASON U. C.R. L.J. 389, 401 n.116 (2008).

to-remedy provisions.[202] But the fundamental arguments would likely channel into two propositions: either litigation budgeting violates litigants' right to due process[203] or their rights to freedom of speech and to petition the government.[204]

a. Due Process. The due-process argument has only a limited effect on litigation budgeting. On the civil side, due process guarantees that parties have notice and an opportunity to be heard,[205] but it does not guarantee access to a lawyer, much less an excessively expensive lawyer of the party's choosing.[206] If approved budgets provide the parties with sufficient funds to be heard, the Due Process Clause should act as no bar to a system of litigation budgeting.

Nevertheless, the Due Process Clause sounds one problematic note for litigation budgets. In *Mathews v. Eldridge*, in which the Social Security Administration failed to provide adversarial evidentiary hearings before terminating benefits, the Supreme Court used a three-factor test to determine whether due process was satisfied. In essence, a procedural rule was constitutional as long as the expected social savings from its use exceeded any expected private loss due to the additional inaccuracy of the nonadversarial procedure.[207] Litigation budgeting, whose point is to ensure that the total costs of litigation do not exceed the total gains, seems consonant with an understanding of due process that is sensitive to balancing costs against benefits and that

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202. *See* Hope Metcalf & Judith Resnik, Essay, Gideon *at Guantánamo: Democratic and Despotic Detention*, 122 YALE L.J. 2504, 2511 (2013) ("[M]any state constitutions have textual commitments to open courts and rights-to-remedies.").

203. U.S. CONST. amend. V, amend. XIV.

204. *Id.* at amend. I.

205. *See* Mathews v. Eldridge, 424 U.S. 319, 333 (1976) ("The fundamental requirement of due process is the opportunity to be heard 'at a meaningful time and in a meaningful manner.'" (quoting Armstrong v. Manzo, 380 U.S. 545, 552 (1965))).

206. *See* Turner v. Rogers, 131 S. Ct. 2507, 2518 (2011) (holding that, as long as procedural safeguards aiding accurate fact-finding are in place, "the Due Process Clause does not automatically require the provision of counsel at civil contempt proceedings to an indigent individual who is subject to a child support order, even if that individual faces incarceration (for up to a year)").

207. The Court described the factors as follows:

> [I]dentification of the specific dictates of due process generally requires consideration of three distinct factors: First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.

Mathews, 424 U.S. at 335. The Court continues to adhere to the *Mathews* due-process formulation. *See Turner*, 131 S. Ct. at 2517–18; Boumediene v. Bush, 553 U.S. 723, 781 (2008); Hamdi v. Rumsfeld, 542 U.S. 507, 529 (2004).

allows courts to alter adversarial procedures in light of social needs.[208] But a potential problem arises because of a simple fact: using different procedures can change the value of a claim.[209]

Assume that, without litigation budgeting, a plaintiff was prepared to spend $10,000 on a claim with a fifty percent chance of returning $40,000 (in other words, a claim with an expected value of $20,000). Further assume that the only value of the suit is the $20,000 private expected recovery, the costs of defense are also $10,000, and the costs to the court are $3,000. It is evident that litigation budgeting is necessary; the plaintiff has an incentive to bring suit (her net private gain is $10,000) even though the social loss from the case is $3,000. Now assume that the court adopts a draconian budget, limiting the expenditures on each side to $1,000. Without the ability to obtain the same level of proof, the plaintiff's chances now fall to a forty percent chance of recovering $10,000 (or $4,000); the costs to the court in deciding the case decline to $1,000. The case is socially worthwhile (the expected gain net of total costs is $1,000), but the plaintiff has lost $12,000 (an expected net gain of $15,000 without budgeting as opposed to an expected net gain of $3,000 with budgeting), while society has gained only $4,000 (moving from a net loss of $3,000 without budgeting to a net gain of $1,000 with budgeting). On these numbers, forcing the parties to adhere to a litigation budget seems to violate *Mathews*.

But this analysis focuses on the wrong question. The *Mathews* factors instruct courts to examine the due-process issue at the macroscopic level: whether in general the total gains from litigation budgeting are greater than the risk of losses to private litigants.[210] They do not examine the application of the rule in a particular case. Otherwise, many procedural rules that limit adversarial options—including recent reforms that limit the scope and frequency of discovery or raise the pleading bar—could be attacked on an as-applied basis. As long as the total gains from litigation budgeting exceed the occasional

208. *Cf.* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 21.1 (7th ed. 2007) (casting the three *Mathews* factors into marginal-utility terms of expected gains versus expected losses).

209. For one discussion of the ways in which legal procedure inevitably affects the value of legal claims, see Jay Tidmarsh, *Procedure, Substance, and* Erie, 64 VAND. L. REV. 877, 885–91 (2011).

210. In *Mathews* itself, the Supreme Court found that a nonadversarial process to determine eligibility for Social Security disability benefits was constitutional even though no evidentiary hearing was held before termination of the benefits. 424 U.S. at 349. In making this determination, the Court weighed the overall benefits and costs of holding such evidentiary hearings, not the particular benefits and costs in the petitioner's specific case. *Id.* at 340–49.

losses to private litigants unable to present as forceful a claim or defense, no due-process issue arises.[211]

This concern, however, suggests that a court should be thoughtful about how it reduces budgets when it must do so. In the last hypothetical, perhaps there exists a middle path between allowing the plaintiff to spend her desired $10,000 and restricting the plaintiff to spending $1,000—a path in which the plaintiff suffers less loss while the social loss is still eliminated.

b. First Amendment. For cases in which a court trims a party's budget, litigation budgeting restricts the amount of money that parties can spend on an activity sponsored by the government. On the surface, therefore, litigation budgeting seems to run afoul of both *Citizens United v. Federal Election Commission*,[212] which held that statutory restrictions on the amounts that corporations could spend on political speech violated the First Amendment's Speech Clause,[213] and *McCutcheon v. Federal Election Commission*,[214] which held that statutory restrictions on the aggregate amount that private parties could contribute to political campaigns similarly violated the Speech Clause.

Despite superficial similarities, however, the use of litigation budgets presents no First Amendment difficulties. To begin, litigation expenditures may not be "speech" that falls within the protection of the First Amendment. Certain categories of expression—for instance, obscenity, incitements to violence, or threats—are exempt from First Amendment protection.[215] These exemptions are "historic and traditional categories long familiar to the bar."[216] Efforts to control the cost of litigation also have a long pedigree[217] and have been a principal

211. It bears repeating that litigation budgeting does not affect or limit the parties' ability to spend the amounts that they wish to spend when (1) the private and public incentives to litigate align and (2) both lawyers are paid by the hour. In these cases, the court's only roles are to approve the budgets and monitor compliance with them. *See supra* Part IV.B.1.a. The due-process concern arises only when litigation is socially costly. Assuming that it works as intended, litigation budgeting avoids those social costs in all of these cases, while the counterbalancing risk of private deprivation of claim value arises only in some of the cases.

212. 558 U.S. 310 (2010).

213. *Id.* at 336–41; *see* U.S. CONST. amend. I ("Congress shall make no law . . . abridging the freedom of speech . . . .").

214. 134 S. Ct. 1434 (2014). *McCutcheon* left in place the $2,600 limit that an individual could contribute to a single political campaign. *See id.* at 1442, 1453 (discussing the $2,600 limit).

215. *See* United States v. Stevens, 559 U.S. 460, 468–69 (2010).

216. *Id.* at 468 (Kennedy, J., concurring in judgment) (quoting Simon & Schuster, Inc. v. Members of N.Y. State Crime Victims Bd., 502 U.S. 105, 127 (1991)).

217. *See*, *e.g.*, Rainey v. W.R. Grace & Co., 231 U.S. 703, 707 (1914) (noting that the "main purpose" of a recent act of Congress was "to reduce the expense of records upon which cases may be taken"); Henry G. Newton, *The United States Bankruptcy Law of 1898*, 9 YALE L.J. 287, 287

focus of procedural reform for more than thirty years.[218] At no point has there been a suggestion that reforms limiting the costliness of litigation create a First Amendment difficulty, even though some of the restrictions—such as limits on the length or number of depositions,[219] limits on the number of days of trial,[220] or limits on the number of pages in briefs[221]—could be seen as efforts to limit a litigant's right of free expression.

None of these other procedural restrictions, however, directly limits the amount of money that parties can spend on litigation. Moreover, as *United States v. Stevens* made clear, speech does not lose its protected quality merely because the costs of speech outweigh its benefits—which is precisely the argument for litigation budgets.[222] The First Amendment arguments have particular force if the approved budgets are so restrictive that a party is unable to articulate its legal views despite its willingness to spend money to do so.

Even granting these arguments, litigation budgeting is akin to other "time, place, and manner" restrictions on the use of a government-sponsored forum (in this case, a courtroom). Such restrictions must be content-neutral, reasonable, applied without stifling free expression, leave open alternative means for communicating the information, and contain "adequate standards to guide the [judge's] decision and render it subject to effective judicial review."[223] As long as a judge acts even-handedly in applying the principles that trim budgets, litigation budgeting should pass constitutional muster.

Indeed, restrictions like limited trial time or word limits on a brief impose far more direct limits on the ability to speak than limits on

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(1900) (stating that one of the objects of the 1898 Bankruptcy Act was "[t]o reduce the fees and expenses to a minimum, . . . and thereby to provide that the assets of the bankrupt shall go to his creditors rather than to officers and lawyers"); Roscoe Pound, *The Causes of Popular Dissatisfaction with the Administration of Justice, Address Before the American Bar Association Annual Convention* (1906), *in* 29 A.B.A. REP. 395 (1906), *reprinted in* 35 F.R.D. 273, 288 (1964) (calling for reforms to American procedure to avoid "the waste and delay caused by archaic judicial organization and obsolete procedure").

218. *See supra* notes 5–9 and accompanying text.

219. *See* FED R. CIV. P. 30(a)(2)(A)(i) (presumptively limiting depositions to ten per side); FED R. CIV. P.; 30(d)(1) (presumptively limiting the duration of each deposition to seven hours).

220. *See* Monotype Corp. v. Int'l Typeface Corp., 43 F.3d 443, 450–51 (9th Cir. 1994) (finding no abuse of discretion when a district court imposed a trial time limit of nine days, even though a party had requested three weeks).

221. *See* SUP. CT. R. 33.1(g) (establishing word limits for various briefs); FED. R. APP. P. 32(a)(7) (same).

222. United States v. Stevens, 559 U.S. 460, 470 (2010) ("The First Amendment's guarantee of free speech does not extend only to categories of speech that survive an ad hoc balancing of relative social costs and benefits.").

223. Thomas v. Chi. Park Dist., 534 U.S. 316, 323 (2002); *see* Ward v. Rock Against Racism, 491 U.S. 781, 791 (1989).

the amount of money that parties may spend, yet such restrictions have never been successfully attacked as violations of the First Amendment.[224] In addition, the directness of the restriction should not matter. If the effort to limit costs through costs budgets is constitutionally infirm, then are not all attempts to restrict a party's ability to spend unlimited money on its case equally suspect? Perhaps the best analogy is to the one part of the Bipartisan Campaign Reform Act that survived First Amendment scrutiny. Even if *Citizens United* allows a person to spend as much money as it wants to explain its political views to the public, *McCutcheon* did not strike down provisions of the Act that allowed the government to regulate the amount of money that a party contributed to a specific political candidate's campaign.[225] The same should hold true for litigation: the amount of money that a party can spend in court may be properly limited.

As with the due process argument, however, the First Amendment argument sounds a note of caution for judges. When they set litigation budgets, they should not let their disagreement about the nature of the claim or defense affect their decision. On the other hand, even-handed and cost-effective restrictions on litigation spending should pose no First Amendment issues.[226]

V. CONCLUSION

Even if courts have the power to require litigation budgets, a separate issue is whether they should do so. Litigation budgeting presents a Rorschach test about a person's views on the importance of limiting litigation costs. Some may see in litigation budgets the newest

224. A search of the Westlaw database found no cases raising the argument.

225. *See* McCutcheon v. FEC, 134 S. Ct. 1434, 1442, 1453 (2014) (discussing the $2,600 limit).

226. Distinct from the First Amendment's Speech Clause is the Petition Clause. *See* U.S. CONST. amend. I ("Congress shall make no law . . . abridging . . . the right of the people . . . to petition the Government for a redress of grievances."). "[T]he Petition Clause protects the right of individuals to appeal to courts and other forums established by the government for resolution of legal disputes." Borough of Duryea v. Guarnieri, 131 U.S. 2488, 2494 (2011). *But see id.* at 2501 (Thomas, J., concurring) ("I seriously doubt that lawsuits are 'petitions' within the original meaning of the Petition Clause of the First Amendment."); *id.* at 2503 (Scalia, J., concurring in the judgment and dissenting in part) ("I find the proposition that a lawsuit is a constitutionally protected 'Petition' quite doubtful."). The right to petition a court does not mean, however, that litigants must be allowed to spend whatever sums they wish on litigation. The Court has recognized that, "[i]n recognition of the substantial costs imposed by litigation," Congress may, without running afoul of the Petition Clause, employ strategies, such as sanctions for filing frivolous claims, that encourage appropriate use of the courts. *Id.* at 2496. Furthermore, although they are not necessarily identical due to the distinct functions of the two clauses, the tests for violations of the Speech and Petition Clauses often converge. *Id.* at 2495, 2500. Because litigation budgeting creates no issues under the Speech Clause, it should pose no problem under the Petition Clause—assuming that the Petition Clause even applies to lawsuits.

manifestation of the creeping and dangerous power of courts to control litigation. Some may be especially uncomfortable with the way in which budgets will regulate, both directly and indirectly, attorney's fees. Some may prefer a far less radical campaign to trim costs around the margin, which is the largely ineffective strategy to which we are presently committed. Some may prefer the status quo of costly litigation, either because they profit from it or because excessive expenses push cases into other forms of dispute resolution that are less transparent and more easily manipulated to their advantage. Some may be attracted to the idea of litigation budgets in theory but are skeptical about whether it can work in practice. And some might think it wiser to wait ten or fifteen years to learn from the British experience with costs budgeting. For these reasons, many may not see the present game of cutting litigation costs as worth the candle if its logical endpoint is judicial control of parties' litigation budgets.

The desire for modest, cautious, and judicious reform is understandable. But such reform is not working. If we are serious about controlling litigation costs and about controlling the hemorrhaging of litigation into other forms of dispute resolution, something innovative is required. The litigation budget is the best option to counteract the parties' desire to overspend on litigation. Litigation budgets are admittedly radical, but they keep litigation costs within socially appropriate bounds. If we are truly committed to this ideal, the argument for litigation budgeting is simple indeed.