

KEYNOTE ADDRESS:

**THE PACE AND EXPENSE OF LITIGATION
IN UNITED STATES COURTS**

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Let me say at the outset that I take considerable counsel from my setting here. It is a large room; it makes me seem very small and insignificant. It is also a room in which you all look down on me. I'm not sure that is entirely literal—there may be some figurative sense in that—and I also note that the clock faces me and not you, perhaps giving me further counsel.

I am here today at the request of Professor Takenaka to discuss the pace and expense of litigation in the United States. Before I do that, I really want to thank Professor Takenaka for the magnificent job she has done in putting together this conference. It is fun to be here among so many eminent professionals, and I learn a great deal just from being present.

Our topic today is the pace and expense of litigation in the United States. It's a very political time in the U.S.; it's always a political time. But politics have taught everyone something, including us judges, and that is that we should be very sensitive to our constituency. So I'm going to perform a poll on this subject and then, of course, I'll know what kind of speech to give. How many favor more expensive litigation? [No hands are raised.] Okay, how many favor lengthy, protracted trials and appeals? [Some giggling.] Okay how about, how many favor a caseload in the United States that is beyond the capacity of the Federal Judiciary to manage? [No response.] Well, I didn't get many people to respond to my poll, but perhaps that gives me counsel as to how I should conduct this speech. I should first give you some statistics on how horrible the expenses of litigation are, and I should tell you some stories about horrendous instances of litigation dragging on at great expense, then I should outline for you how the case load growth has magnified the delays in the U.S. Court system and those delays which in turn makes litigation more expensive. Therefore the litigious

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society, all of *us* being more responsible than most, are causing this horrible, lamentable situation. I would then continue on to say that this must not continue, that we must all feel guilty about this. I would then, of course, wisely blame attorneys because their attorney's fees are so high, and I would conclude by suggesting, well, let's just shift attorney's fees—thereby squeezing attorneys more, and you would all, in the end, leap to your feet at the eloquence, the insight and, using the current political word, the *compassion* of my remarks. Well, as you can guess, instead of being eloquent, insightful, and compassionate, I've decided to be mundane, obvious and very unfeeling. Instead, I'd like to look at this whole question of expense of litigation from a little different perspective.

First, let's consider the dimensions of the problem, if it is a problem. This is one of my favorite statistics: as law school enrollment grows, so declines economic growth. Therefore, in my work as a law school professor, I can establish that I am directly contributing to the decline and fall of civilization worldwide. I obviously invoke this image for more than humor, more than actual impact. There is an expense, there is a cost to litigation, which such statistics do capture. There is at least a significant effect on most statistics on caseload growth in the United States. If you look at about 1960, you see a dramatic rise in the number of filings in district courts in the United States. The logic would proceed that those filings do indeed contribute to a burden on the system that causes delays and magnifies expense. There is a similar rise in appeals. The appeals are always somewhat lower than the trials, for reasons we'll explain, I hope, a little bit later.

Oh yes, I've got to tell you an anecdote too, don't I? So that you're completely scared. This is a case pending before me at the moment. It started in 1981, and was first tried in 1987. It was reversed on two occasions by the Federal Circuit. You see that only gets you to 1991. To go on, the case has now been on appeal or in the trial system for seventeen years. There have been nine major court decisions including the last, which will be issued in a few weeks. Now you're supposed to look upon this with great disdain as a sign of failure of the system. I'm obviously not going to argue that. Rather, I'd like us to think for just a moment: why, if these expenses are so high, if this is such a drag on the economy as the statistics on GNP consumption suggest, why do we tolerate the expense of litigation? You see my first hypothesis. That it is in fact not expensive, but incredibly cheap. How could one make a statement like that?

Well, let me tell you a story. I was... I don't know if Judge Coughenour is here yet, I haven't seen Jack. He is an excellent district judge here. He and I first went to the Soviet Union, when it was still the Soviet Union, and

a few years after that I was for an extended period of time in the Ukraine. I was with my interpreter in Ukraine and we entered a large state-owned department store and climbed the stairs up to the fourth floor. At the third floor there was a hole in the stairwell. It was about three feet by three feet, entirely unmarked, and quite frankly right by the handrail. Someone going up, holding the handrail, would fall directly into this hole and drop a story below to the stairs. I came upon this hazard and I turned with great shock to my interpreter and said, "Wow! You know if that hole existed in a department store in the United States, I could fall into that hole, break my ankle and sue this store for two million dollars!" That's conservative by the way. My interpreter, with great sincerity turns to me and says, "Take me to America, I'll fall into the hole and we'll split the costs—we'll split the take." And suddenly our system came into a little more concrete focus for me. Because I was able to turn to Vallia and say, "Valentin, the point is that in the United States, there are no such holes to fall in." "Impossible," he said, "I mean, every store here has such hazards. There has got to be those problems." "No Vallia, because there is that threat of liability, the instant there was a problem, it would be cordoned off, corrected and avoided voluntarily by the store. To avoid any liability."

Valentine's mind turned quickly. He said, "Yes, but things work differently here. We have a department of public buildings. We have a department of public streets. We have a department of housing, a department of hazards. All of those people combine to solve these sorts of problems." I said, "Well that's good Vallia. I've got a couple of questions: How long will this hole stay here?" "Oh, three months." "Okay, how much does it cost you for your system?" "Well," starting out he says, "taxes are around 79-80%, so none of us pay them, and these vast agencies don't do their jobs very well."

Well, what am I saying here? I'm saying that the cost of litigation may be the price of the rule of law system. The rule of law system being that marvelous voluntary system of enforcing order within society. Yes, voluntary compliance with societal norms must be enforced on occasion by this tort system, or by the intellectual property system, or whatever other system we have to insure that people do voluntarily comply. But, in general it is much more efficient. There is less cost even if you say, as I have seen in some studies, that costs are as high as 5% of GNP. That 5% of GNP is far less than the alternative for ordering society of vast agencies and vast tax bills.

That of course is not the whole story. There is another part of the cost that must be taken into account: most of the American system of justice is not that expensive. I've had an occasion to find myself in traffic court. Why

are you laughing? The only person in the room to know me well laughs. I think that may be an indication of how I drive. I found myself in court, with a full chance to explain my situation—fifteen or twenty minutes. It cost me twenty dollars in court costs. That's really pretty reasonable for the domestic-relations/juvenile-justice/traffic sort of situations that most Americans encounter in their interface with the legal system. The cost is really quite reasonable. Subsidized? Yes, it is subsidized. But the cost is reasonable.

The cost of the more complex cases, like the one I mentioned a moment ago that had gone on for seventeen years, would therefore seem to be quite a different category. I think part of the answer to that category.... As I have suggested, it is a cost of the rule of law system—which is far more efficient than any alternative I have been able to locate in the world.

There is a further hypothesis that I might add, as to the cost of trial: litigation expenses are a tolerable consequence of the American model of dispute resolution. Perhaps that is just a corollary to what I just said, that it is a cost of the rule of law system.

But what I'm really saying is that the costs keep the courts in their proper place in the system. The courts are not a guarantor of all resolution of all disputes; rather, in the American system of Justice we prefer to encourage private settlement. In America, the courts are not here to solve all the problems. They're not here to repair all the holes in the stairways in every department store in America, they're not here to guarantee that everyone gets the right cost for anything, whether it be intellectual property or the rent they pay on their apartment. Rather, the court is a kind of a safety net. It is the final arbiter to whom you can turn when all private resolution mechanisms fail. The cost of the system ensures the courts stay within that limited role in the system.

Now it's a little against my interest to say this because, you know it would be much better for me to tell you that I am important and that you must come to me to resolve all of your disputes. But I think that is not true. I think the system operates, and can only operate, when I am the exception to the rule for dispute resolution. Indeed, I think if you ask my brother colleagues here, if we had to resolve all of the disputes that are filed with the courts, the courts would collapse under the workload. We could not manage to handle such a continuing growth curve. We have to rely on settlements—not just settlements, there are many forms of private resolution outside of the court system—but we are as reliant on that as the system is for its entire functions.

Let's examine for a moment the economics that suggest why the system works this way, and how the system and its costs actually encourage private

resolution of disputes rather than court resolution. As I mentioned, litigants are going to weigh the costs of a lawsuit versus the alternatives. The alternatives are private systems of resolution.

The formulas, the things that affect the decision to use the court system, to litigate by a lawsuit, if you will, are the following factors: the judgment of the litigants as to the probability of success—how likely am I to win? They will factor how much they will win—ten dollars, a hundred dollars, a hundred thousand dollars—and of course they will figure in the cost of a lawsuit. Economists will call this transactional costs. Thus for the plaintiffs the value of the suit will be the probability times the amount they'll get, but then they've got to subtract out the costs of obtaining that judgment. That gives you the value of the suit. Its another way of saying that if your expected income from a lawsuit exceeds the cost, you can assume you're going to go to the courts. Now, the defendants also have an equation. They're going to have the same factors: the chance they'll lose times the amount they'll lose, and of course to that they have to add the cost of defending themselves. That is a further deficit to them.

So what produces a settlement? We'll plug some numbers in and I think you'll see the incentives for settlement in the system. Lets assume the plaintiff figures he's got a 60% chance of winning—better than even. He is going to win \$100,000 dollars, and it's going to cost him \$20,000 to litigate. If you multiply these out, and subtract the \$20,000, you'll find that he figures he has got \$40,000 at net value in this suit. Some economist is going to quickly jump on me and say there is a lot you're not counting in: what about the cost of settlement itself? Yes, there are those costs. I am making it simple and factoring those out. The defendant using the defendant's economic calculation will come up with a net cost to him of the suit—he is likely to lose \$80,000. So both parties are better off if they can settle for anywhere between \$40,000 and \$80,000—minus of course some settlement costs, but there is a margin for them to settle. Interestingly, the costs of the suit are a part of the incentive.

Now why, do you ask, don't more suits settle? Why don't all suits settle? Because the costs of settlement are always going to be less than the cost of litigation? So, if you have the formula like I just gave, in every instance it should settle, right? As long as the costs of settlement are less than the cost of litigation. The answer is, of course, that a key variable does not remain uniform between the plaintiff and the defendant. What is that variable? Their estimation of the likelihood of success or failure. In other words, if they are uncertain about the outcome and that uncertainty causes them to reach wildly different estimations of who is going to win the suit—

the plaintiff figures he is going to win big, and the defendant thinks, "I'm not going to lose a penny here." Then when you figure that in, times the amount of judgment... which may vary too, though that's very unlikely. The parties generally know how much is at stake, or they calculate it within a close margin. That uncertainty in the outcome becomes the key determinant of whether or not there is going to be a settlement or a lawsuit. Again, putting in numbers: the plaintiff is still confident he is going to win, but the defendant still believes there is not a chance he is going to lose. Then you can see there is no room for settlement, there is no value which they can agree on, the plaintiff is expecting more than the defendant ever thinks he is going to lose.

In any event, as the cost increases so does the margin for settlement. Uncertainty in outcomes is the key value in this... and we'll think for a minute about what causes these uncertainties in outcomes. Ultimately uncertainty increases both the estimations of the parties, the prospects of their success as they see it. And it affects the cost of the lawsuit because it likely produces more chance of litigation than stringing out those expenses. Thus, uncertainty in the law becomes a key factor that influences whether or not you settle.

The judiciary has an incentive, of course to eliminate uncertainty. The question is why then is there uncertainty in the system? There are perhaps lots of reasons for this. One quick reason is suggested by the question: why did there suddenly become more uncertainty in the law in 1960, such that far more lawsuits and fewer settlements were produced? Certainly, new areas of law, new areas of enterprise: airlines suddenly began flying passengers, and it would be many years until the system would decide who is liable for any costs of airline transportation. Those costs could be the costs of crashes or just the decline in property values due to the noise from airline overflights.

Whatever the area of new technology or new law there is going to be a period of great uncertainty that will increase the likelihood of lawsuits. New rights have been created by Congress and the Courts—particularly starting in the 1960's. Again, new rights create new uncertainties of how they will be enforced, that increases the likelihood of more lawsuits, fewer settlements. And, with the growth of the judiciary itself, with more judges and more opinions, there is less unanimity as to the meaning of the law, so you have yet more uncertainty and fewer settlements. Of course, just the growth and complexity of society is a factor—with more people there are more disputes and more uncertainty.

This gives me a chance to look at my own court for a minute. If, as I postulate, uncertainty in the law and outcomes is what causes more lawsuits and more expense in the system—and greater costs of the enforcement of this magnificent rule of law system—if we want to hold those costs down a bit we would want to have more certainty in the law... then what better model could we offer than the Federal Circuit? Because there is probably consensus in this room and in the legal field that the Federal Circuit has brought vast certainty to a previously very uncertain field of law, patent law.

So we would say, after having brought certainty, we would expect a vast decline in the number of suits and appeals occurring in patent law. Right? Well, if you consider the past ten years or more, going back to 1988, yeah, there is a little decrease. But, frankly, it is a little disappointing for my thesis. Don't I know that I'm trumpeting the virtues of more certain law, yet that doesn't seem to really have caused a vast decline of the number of suits. How can we explain this?

Well, of course I could hem and haw and look at my shoes for a moment in embarrassment. But I think there are some explanations. First, in this particular area, certainty in the law has brought a vast expanse in its use. There have been more patents filed, and there have been more efforts to enforce the additional patents that have been filed. With more chances for disputes, there are more chances that within those disputes the parties will hit uncertain areas of the law and, of course, end up in litigation.

Another possible explanation is that this expanse in the use of the system is also driven by the international intellectual property marketplace; it isn't just a Federal Circuit phenomenon. The Federal Circuit has got a vast number of suits that are in effect generated by the international intellectual property laws that probably weren't there prior to the Federal Circuits' creation.

And finally—with some embarrassment, and to the delight of my trial court colleagues—I would have to concede that the Federal Court has itself engendered some uncertainty in some areas, and those uncertainties have spawned more litigation, to the extent that there is not the ability to see an early outcome. That promotes more appeals, and more likely leads to litigation and not private settlement.

Because we have so many foreign legal scholars here, I was going to examine a subject which I have thought about a great deal recently in my international travels: the varying systems of judicial administration. The classic European civil law model versus the American common law model, which encourages private dispute resolution. I really don't have time to deal with all my thoughts as to whether or not there is going to be a conflict of

those systems or convergence. But I think you can see areas in which the systems are converging; where the marketplace, the international forces that require some kind of certainty on an international level, are forcing the systems to converge. One interesting example is that civil law systems appear to be taking on more of the common law emphasis on, or at least tolerance of, law-making in the process of resolving disputes—something which has always been a hallmark of the American judicial system. I see a convergence there. One of my colleagues on the Seventh Circuit, Judge Posner, has written a book on the subject. He says that there is probably convergence in the area of specialized courts. He sees the United States moving to more specialized courts; he cites my court as an example. I think I'd argue with him a bit, but he says at least there is some convergence there.

I do not see much convergence, on the other hand, in things like this: the ratio of judges to attorneys in America, at least in the Federal system, has stayed reasonable low. This is something which, in our private resolution model, we encourage. Why? Because the attorneys are the ones who actually make the law certain, through their interpretations to their clients, and end up being the facilitators of private dispute resolution. You want more attorneys than judges, the judges being the safety net, the attorneys being the actual implementers of this majestic rule-of-law/private-dispute-resolution system.

I think the international marketplace will continue to drive convergence. I think we're going to continue to look a little more like the international courts, and the international courts are going to be driven to use more of the American model of decision-making as well.

A final point, since I threatened to make fun of attorneys—they being the great cost in the system. Of course you can perhaps detect the course of my argument here; it would be that since attorneys are the facilitators of the system, the cost should go to them. They are doing the work, they deserve the pay. Yet it's a popular idea that attorneys are the cause of the cost increase—this is kind of a popular idea that doctors have put forth for the responsibility of the healthcare increases. So the idea is, let's shift the fees—everyplace except the United States and Japan does anyway—so that the winner gets all the fees. The idea being, this would penalize excessive optimism. Remember what causes settlement, or what inhibits settlement? When somebody has a wildly disproportionate assessment of the value of the likelihood of success of their suit, we're going to punish that by building in an extra cost, by fee shifting. This would then reduce case loads, reduce delays and alleviate expense problems throughout the system.

But it is never that easy; there is also a potential expense to fee shifting. In fact, you can argue quite strongly that fee shifting works as a disincentive to actual settlement and more efficient decision making. Why? Well, here's the way it works: it makes litigation more likely when both the parties are overly optimistic—and the argument is that those are the only kinds of cases that won't settle anyway. If one of the parties is reasonable, there will always be some margin for settlement.

Here's the hypothetical that illustrates the possible problem for fee shifting: you've got a judgment value of "X," attorneys fees of about one third of that, and each of the parties senses they have a seventy percent chance of winning. Under the American rule, which is that everyone pays their own fees, we plug in the costs and we find that there is a margin for settlement. It's kind of another way of looking at that initial settlement model that we examined earlier. But now factor in the English rule of shifting the fees to the winner. You'll have to trust me that this is the proper calculation for factoring it in, but if you trust me, then we could go through it and I think I could show you that the English rule has eliminated the margin for settlement. There is no margin there, or practically none, because of the way it affects the incentives. Now which way does fee shifting work: to encourage more litigation or to discourage litigation? Frankly, I've looked at the literature and it is hopelessly conflicted. There are about as many people who adopt this model as adopt the opposing model that say it would encourage more settlements. And there is not an effective way to empirically measure it.

In sum, we started out by saying that expensive litigation is an enormous problem. I hope that I have caused you to at least think that it is not a problem anymore, but merely a cost of the rule of law system. It may be the most inexpensive system for societal dispute resolution that there is in the world. That doesn't mean that we shouldn't try to make the system more efficient and try to reduce those costs even further. But there may also be limits as to how much you want to reduce the costs of the most efficient system in the world before you start to jeopardize it. I'm sorry, I've been as mundane and obvious and as unfeeling as I could be. Thank you very much for your attention.

