

THE IMPACT OF DIFFERENT COSTS REGIMES ON DISPUTANTS' CHOICES

- 1.1 This paper discusses research into the impact of different costs rules (“the UK rule” that the loser pays the winner’s costs, sometimes referred to as “fee shifting”, and “the US rule” that each side bears their own costs).
- 1.2 This document does not represent the Law Commission’s official view of the matters discussed, nor is it an authoritative statement of the law.
- 1.3 It was completed in September 2005.
- 1.4 There appears to be little agreement between law and economics scholars modelling the issue theoretically. Some statistical and experimental work suggests that:

The US rule causes more low-merit claims to be filed. The UK rule causes higher expenditure and a higher proportion of filed cases to be dropped. The UK rule may produce a lower settlement rate. The net effect of these factors on the number of trials is ambiguous. A further complicating factor is risk aversion amongst the parties.¹
- 1.5 Some leasehold valuation tribunal litigants interviewed by Blandy and others had been dissuaded by the costs rules from bringing cases in the county courts, but litigated when jurisdiction was transferred to the Leasehold Valuation Tribunal where they were not at risk of paying the winner’s costs.² Even where the tribunal cannot or does not order the tenant to pay the successful landlord’s costs, the terms of a lease may allow the landlord to recover them through a service charge. The tenant may apply under section 20C of the Landlord and Tenant Act 1985 to prevent this.
- 1.6 Leggatt was not persuaded that tribunals’ costs powers needed extending.³

¹ G Bevan, P Fenn and N Rickman, Contracting For Legal Services With Different Costs Rules (March 1998), Lord Chancellor’s Department Research Series 3/98, p v, para 3.

² S Blandy, I Cole, C Hunter, D Robinson, R Inniss and S Kane, Leasehold Valuation Tribunals: Extending the Remit – Analysis of appointment of a manager, insurance disputes and service charges cases before Leasehold Valuation Tribunals (January 2001), Department of the Environment, Transport and the Regions.

³ Tribunals for Users One System, One Service – Report of the Review of Tribunals by Sir Andrew Leggatt (2001) Department for Constitutional Affairs.

Law and economics work on costs

1.7 I have looked at three literature reviews citing papers on the impact of the UK and US costs rules,⁴ and searched for more recent work as well. Neil Rickman cautioned that most of the research is from the US, generally concerns personal injury litigation, and is mostly based on data from closed cases from defendants' files.⁵ Clear conclusions are hard to pin down: some studies are inconclusive, and theorists disagree. Disagreement may result from theorists' different assumptions (eg as to risk aversion, or informational asymmetry - where the claimant knows the quantum of damages and the defendant does not, or where the defendant knows if he is liable but the claimant does not).

1.8 Ogus and Amass comment that:

... *Gravelle*, 1989 and 1993,⁶ finds it difficult to reach clear conclusions on the merits of the rule; *Bowles*, 1987,⁷ considers that, when account is taken also of the taxation of costs and the payment-in rules, the differences between the English and the American approaches are reduced.

1.9 Kritzer notes that:

There is surprisingly little agreement among those who have undertaken these theoretical analyses. Some analysts argue that fee shifting should increase the likelihood of settlement while others argue that it will increase the likelihood of cases going to trial. Some argue that the number of cases filed will go down while others argue it will go up, although this difference in part reflects what types of cases analysts consider (ie weak cases will be less likely to be brought while strong modest value cases may be more likely to be brought). Katz nicely summarizes the uncertainty:

⁴ A Ogus and R Amass, *Research Review on Law-and-Economics: State of the Art and Questions for the Future* (December 1997) Lord Chancellor's Department Research Series 4/97; N Rickman, *The Empirical Analysis of Litigation: A Survey of the Economics Literature* (March 1998), Lord Chancellor's Department Research Series 2/98; and H M Kritzer, "Lawyer Fees and Lawyer Behaviour in Litigation: What Does the Empirical Literature Really Say?" (2002), 80 *Texas Law Review* p 1943, 1952.

⁵ N Rickman, *The Empirical Analysis of Litigation: A Survey of the Economics Literature* (March 1998), Lord Chancellor's Department Research Series 2/98, p 7.

⁶ H S E Gravelle, "Accidents and the Allocation of Legal Costs with an Uninformed Court" (1989) 14 *Geneva Papers on Risk and Insurance*, 11; H S E Gravelle, "The Efficiency Implications of Cost-Shifting Rules", (1993) 13 *International Review of Law and Economics*, 3. Rickman referred to Gravelle's 1993 paper as one of the principal "one-shot" strategic theoretical papers. Other key papers cited by Rickman were S Shavell, "Suit, Settlement and Trial: A Theoretical Analysis under Alternative Methods for the Allocation of Legal Costs" (1982) 11 *Journal of Legal Studies*, and G Fournier and T Zuehlke, "The Timing of Out-of-Court Settlement" (1996) 27 *RAND Journal of Economics*, 310.

⁷ R Bowles, "Settlement Range and Cost Allocation Rules: A Comment on Avery Katz's Measuring the Demand for Litigation: Is the English Rule really cheaper?" (1987) 3 *Journal of Law, Economics and Organisation*, 177.

[T]he current state of economic knowledge does not enable us to reliably predict whether a move to fuller indemnification would raise or lower the total costs of litigation, let alone whether it would align those costs with any social benefits they might generate. The reason for this agnostic conclusion is straightforward. Legal costs influence all aspects of the litigation process, from the decision to file suit to the choice between settlement and trial to the question whether to take precautions against a dispute in the first place... The combination of all these external effects are too complicated to be remedied by a simple rule of “loser pays”. Instead, indemnity of legal fees remedies some externalities while failing to address and even exacerbating others.⁸

1.10 Some of the predictions made by the theoretical models have been tested with empirical techniques. These techniques include:

- (1) econometric (statistical) analysis, which looks at numbers of cases filed, dropped, settled and tried, as well as monetary costs and recoveries, and generally requires a particular jurisdiction to have operated both the UK and US costs rules;
- (2) laboratory experiments simulating settlement bargaining; and
- (3) interview studies asking lawyers for their views on the effect of the rules.

1.11 New theoretical models continue to be developed as well. The bold headings below are taken from Rickman’s summary of the empirically tested theoretical predictions.⁹

⁸ A W Katz, “Indemnity of Legal Fees” in Bouckaert and De Geest (eds) *Encyclopaedia of Law and Economics, Volume V, The Economics of Crime and Litigation* (2000).

⁹ See N Rickman, *The Empirical Analysis of Litigation: A Survey of the Economics Literature* (March 1998), Lord Chancellor’s Department Research Series 2/98, p 21.

The UK rule will cause litigants to spend more on their cases than the US rules because:

(a) they anticipate passing on a fraction of their costs; and

(b) the UK rule increases the stakes (the difference between winning and losing).

- 1.12 The key statistical study was carried out by Snyder and Hughes, who analysed 10,325 medical malpractice cases in Florida from the late 1970s to mid 1980s, 58% of which were litigated under the UK rule.¹⁰ Snyder and Hughes used their results to predict defendant expenditure on a representative case. Their results confirmed the prediction that parties' expenditures will be higher under the UK rule than the US. They estimated that for cases settled, defendant expenditure would be \$10,890 under the UK rule, but \$7,428 under the US rule, and for cases at trial, expenditure would be \$20,775 under the UK rule, and \$12,775 under the US rule.
- 1.13 1.9 A recent theoretical paper, focusing on the effect of different rules on legal expenditure is M R Baye, D Kovenock and C G de Vries "Comparative Analysis of Litigation Systems: An Auction-theoretic Approach".¹¹ Their model, unlike some, assumed that spending more on lawyers increases the quality of the case presented, when the party putting forward the best case wins. They found that, assuming the case goes to trial, the US rule and the Quayle rule (where the loser pays the winner the same amount for legal costs as the loser spent on legal costs) result in lower expected legal expenditure than the UK rule or the Continental rule (where the loser pays his own legal costs plus a fixed fraction of the winner's legal costs).
- 1.14 C E Hyde and P L Williams in "Necessary costs and expenditure incentives under the English rule" looked at the effect on litigation expenditure of restrictions on the UK rule where the loser only pays the winner's "necessary" or "proper" costs, not indemnity costs.¹²
- (1) While the expenditure of the higher spending party increases steadily with the amount of costs that can be shifted, this is not necessarily true for the other party.
 - (2) The US rule is welfare maximising for suits in which litigation expenditures serve primarily to sway an impressionable jury rather than to allow discovery of the underlying facts of the case.
 - (3) Ceteris paribus, parties have more incentive to settle when they anticipate the costs of going to trial to be higher, implying that actual expenditure may be lowest when potential trial expenditures are highest.

¹⁰ E Snyder and J Hughes, "The English Rule for Allocating Legal Costs: Evidence Confronts Theory" (1990) 6 Journal of Law, Economics and Organisation, 345; J Hughes and E Snyder, "Litigation and Settlement under the English and American Rules: Theory and Evidence" (1995) 28 Journal of Law and Economics, 225.

¹¹ (July 2005) 115 Economic Journal, 583-601.

¹² (August 2002) 22 International Review of Law and Economics 2, pp 133-152.

- (4) Limits on fee-shifting are have no impact on expenditure on legal costs in cases where only quantum, not liability is in dispute.
 - (5) Increased litigant uncertainty about the definition of necessary costs can decrease expenditure on legal costs if both litigants' expenditures are already low, relative to expected necessary costs, while increasing expenditure if they are initially high.
- 1.15 Another very recent theoretical paper is A Klement and Z Neeman “Against Compromise: A Mechanism Design Approach”.¹³ This paper attempted to look at both procedural and substantive considerations in the search for an optimal procedural mechanism. They found that reducing per case litigation costs would reduce total litigation costs (where other theories had predicted lower per case costs would lead to more litigation). Where the social goals of justice and deterrence are imposed as a constraint on the settlement procedure, the UK rule minimises the cost and likelihood of litigation.
- 1.16 K N Hylton, in “An asymmetric-information model of litigation”,¹⁴ described “a cradle-to-grave model of tort liability”, incorporating the decision to comply with the due-care standard, the decision to file suit, and the decision to settle. This model assumed that all actors are risk neutral and that only the defendant knows whether he complied with the due care standard. Hylton concluded that in terms of total welfare (the negative of the sum of injury costs, avoidance costs and litigation costs), the UK rule is best, followed by the pro-plaintiff (plaintiff pays his own litigation costs only if he loses), US and pro-defendant (defendant pays his own litigation costs only if he loses). In this model, the UK rule generates the highest level of compliance with the due care standard because it maximises the spread between the expected liability levels of “guilty” (ie liable) and innocent defendants.
- If the parties are not risk averse, the UK rule will cause cases to be filed with a higher probability of success than the US rule, whereas more weak cases will be filed under the US rule. However, as cases proceed and costs rise, a number of high merit but small value claims will be dropped under the UK rule. Overall, we would therefore expect to see a higher plaintiff win rate at trial under the UK rule, along with larger trial judgments for plaintiffs and, possibly, higher settlement amounts.**
- 1.17 Snyder and Hughes did find that the UK rule raised the probability of a case being dropped after filing. The UK rule encourages low claims to be filed, but as information about their costs becomes available they are dropped. This may be due to plaintiff risk aversion, as information emerges.
- 1.18 In their 1990 paper, Snyder and Hughes used their findings to predict how a hypothetical sample of cases would be treated under the UK and US rules.

¹³ (2005) 21 Journal of Law, Economics and Organization 2, p 285.

¹⁴ (August 2002) 22 International Review of Law and Economics 2, pp 153-175.

Predictions of Case Numbers Dropped, Settled and Tried from Snyder and Hughes (1990)				
	Number filed	Number dropped	Number settled	Number tried
US rule	1,000	435	458	107
UK rule	1,000	539	404	57

- 1.19 They predicted that if 1,000 cases were filed under the US rule and under the UK rule, over 100 more would be dropped under the UK rule than the US rule. Roughly half as many cases were predicted to go to trial under the UK rule. Although the UK rule makes trial more likely for a given case, if it is not dropped, because the rule leads to more cases being dropped, overall, it leads to fewer cases going to trial. It appears that the UK rule causes a more careful evaluation of the case’s strengths to take place, once it has been filed.
- 1.20 In their 1995 paper, Hughes and Snyder found that the UK rule increases the probability of a plaintiff succeeding at trial by 8.2%, among those cases “selected” for trial. Plaintiff win rates averaged 21.6% compared to 11.4% for cases operated under the US rule. Where the plaintiff won, judgments were 240% higher under the UK rule. The distribution of judgments suggested that the UK rule induced relatively more high value cases to go to trial. Hughes and Snyder also found that UK rule settlements were generally higher. Controlling for other factors indicates that settlements under the UK rule are 30% more likely.
- 1.21 In contrast, Coursey and Stanley’s study simulating litigation settlement bargaining found that the UK rule also placed relatively more bargaining power in the hands of a party with a strong case.¹⁵ When the bargaining environment was unfavourable to one party (ie they had a weak case) that party received a smaller settlement under the UK rule.
- 1.22 In a more recent theoretical paper R Aoki and J Hu “Allocation of Legal Costs and Patent Litigation: A Co-operative Game Approach”,¹⁶ agreed with Hughes and Snyder that the UK rule increased plaintiff success rates at trial, average court damages awards and out of court settlements if both parties believe that the plaintiff is more likely to win at trial.

¹⁵ D Coursey and L Stanley, “Pre-Trial Bargaining Behaviour Within the Shadow of the Law: Theory and Experimental Evidence” (1988) 8 International Review of Law and Economics, 161.

¹⁶ (August 1996) econwpa.wustl.edu/eps/io/papers/9612/9612001.pdf.

- 1.23 Rickman comments that Snyder and Hughes's results raise the question of whether the UK rule taxes litigants and therefore possibly damages the prospects of small, reasonably meritorious claims at the margin, or whether it acts as a screening device for ensuring that cases proceeding through the litigation system are of high merit. According to Kritzer, overall, Snyder and Hughes conclude that the UK rule reduces the frequency of low merit claims, encouraging plaintiffs with strong cases and discouraging those with weak cases.¹⁷
- 1.24 Kritzer cites a study of federal constitutional tort cases, where there is a one-way fee shifting rule (the unsuccessful state pays the successful claimant's costs, but an unsuccessful claimant does not pay the successful state's costs). The authors found no clear evidence that the availability of fee awards led to an increase in the number of cases filed.¹⁸ They did find evidence that a higher proportion of cases were litigated after fee awards, but that the rate of success for litigated cases actually declined. Kritzer suggests that:
- ...this would indicate that the availability of fee awards did not increase the willingness of litigants and lawyers to try strong modest cases; rather, it suggests that plaintiffs probably changed their bargaining behaviour in a way that resulted in fewer settlements.
- 1.25 The effect of the UK rule in filtering out hopeless cases was discussed by A Farmer and P Pecorino in "A Reputation for Being a Nuisance: Frivolous Lawsuits and Fee Shifting in a Repeated Play Game".¹⁹ Their model showed that the UK rule will reduce the number of nuisance suits (ones which both parties know will not succeed at trial). Under the US rule, the claimant lawyer can pursue a nuisance suit to trial, which makes the threat of filing one credible. The risk of costs under the UK rule means no nuisance cases go to trial, reducing the credibility of the lawyer's threat to file them and so his incentive to file them.
- If the parties are not risk averse, the UK rule will generate less settlement of cases than the US rule when both parties are optimistic about their chances at trial (ie when both think their prospects of winning are high).**
- 1.26 Snyder and Hughes' research showed that amongst cases which were not dropped, the UK rule raised the likelihood of going to trial, as if the optimism effect outweighed litigant risk aversion and higher expenditure.
- 1.27 Snyder and Hughes's work shows that the whole litigation process needs to be examined to judge the effects of cost-shifting on the number of cases going to trial. Only after looking at cases dropped and cases settled could they conclude that overall the UK rule would lead to fewer cases going to trial than the US rule.
- 1.28 Bevan, Fenn and Rickman also took a wide view of the litigation process, commenting briefly on the effect of costs rules on the rate of accidents (ie potential cases):

¹⁷ H M Kritzer, "Lawyer Fees and Lawyer Behaviour in Litigation: What Does the Empirical Literature Really Say?" (2002), 80 Texas Law Review p 1943, 1952.

¹⁸ S J Schwab and T Eisenberg "Explaining Constitutional Tort Litigation: The Influence of the Attorney Fees Statute and the Government as Defendant" (1988) 73 Cornell Law Review 719.

This will, in part, be determined by the care individuals take in their daily business which will, in part, be influenced by the chances of a legal case being brought against them if they are involved in an accident. In general, we would expect individuals to take more care if they face a high chance of a suit being filed against them, of having to make a high settlement offer, or of having to go to trial. From above, we know how the costs rules affect settlement and filing behaviour. For example, we know that the UK rule will cause less settlement if both parties are risk neutral and optimistic about their chances at trial. We also know that such a plaintiff will be more likely to file a suit. Given this, we would predict that there will be fewer accidents under the UK rule than under the US rule, when these assumptions hold. The outcome when these assumptions are changed is less clear.²⁰

- 1.29 Kritzer comments on 2 unpublished English statistical surveys.²¹ In one, looking at 220 High Court tort case histories, Timothy Swanson showed that the likelihood that the defendant will make an initial offer decreases as the level of risk facing the plaintiff increases. Risk to the plaintiff was measured by how the plaintiff was funded, and whether he is at risk of having to pay the other side's costs if he loses. Swanson found that a settlement offer is most likely when the plaintiff is supported by a trade union against the costs of losing (offers in 90% of such cases) and least likely when the plaintiff privately funds the litigation and is fully at risk for those costs (offers in 53% of such cases). Where the plaintiff is legally aided, there were offers in 66% of cases. If the plaintiff refused the first offer, the likelihood of receiving a second (and even third) offer is the same.
- 1.30 Paul Fenn's study looked at the likelihood an insurance company defendant would make an offer. It examined 224 cases collected by a team at the Oxford Centre for Socio-Legal Studies. It showed that the likelihood of an offer is a function of the way the plaintiff's solicitor is to be paid, being lowest if the plaintiff is unrepresented, and increasing if the plaintiff is paying for his solicitor himself, then if the solicitor is retained by a trade union, and then legally aided. Offers of settlement appeared more frequent in this study than in Swanson's – Kritzer suggests as a reason the fact that Swanson's analysis included only those cases where a formal legal action had been filed, leading to substantial conflict.
- 1.31 Kritzer concludes that taken together, Fenn's and Swanson's studies show that:

¹⁹ (1998) 18 International Review of Law and Economics 2, pp 147-157.

²⁰ G Bevan, P Fenn and N Rickman, Contracting For Legal Services With Different Costs Rules (March 1998), Lord Chancellor's Department Research Series 3/98, pp 11-12.

²¹ T Swanson "The Repeat Player in Dispute Resolution: Its Impact Upon Civil Litigation" (1988); P Fenn "Bargaining Behavior by Defendant Insurers: An Economic Model" (1988), both described in H Kritzer *Let's Make a Deal: Understanding the Negotiation Process in Ordinary Litigation* (1991), pp 93-97.

in a fee shifting regime, a repeat player insurance company has an enhanced advantage vis-à-vis a one shot player. If the plaintiff can be protected in some way from the risks of paying the other side's fee, then the defendant will be more willing to make a settlement offer. Where the plaintiff is fully at risk, the defendant can refuse to make [an offer] in the hope that the plaintiff will withdraw the claim rather than run the risk of a cost award.²²

- 1.32 R Cooter, S Marks and R Mnookin, "Bargaining in the Shadow of the Law",²³ predicted that for optimistic litigants who are risk neutral or slightly risk averse, trial would be more attractive under the UK rule than the US because of the higher expected value of a trial award. They thought that trial would be more attractive under the US rule than the UK rule for pessimistic litigants and extremely risk-averse persons (higher expected value, less risk). However, because they consider trial to result from strategic behaviour, not optimism, they predict a smaller proportion of suits will come to trial under the UK rule than the US.
- 1.33 According to Kritzer, evidence suggests that a one way fee shifting rule (allowing successful individual claimants against the state to recover their legal costs, but not vice versa) has increased the willingness of lawyers to bring cases of significant policy import.²⁴ Two-way fee shifting systems can also encourage such litigation, particularly if there are mechanisms that provide at least some protections against the risks to certain groups that might bring such cases.²⁵
- 1.34 In another study cited by Kritzer looking at a variety of federal cases including property disputes, the authors found no statistically discernible evidence that the fee shifting regime influenced either the likelihood of settlement or the settlement demand.²⁶ Kritzer criticised the authors for not spelling out which cases were governed by the UK rule, or why they said those cases were governed by it.
- 1.35 Kritzer refers to another US statistical study by the Alaska Judicial Council in 1994, looking at Alaska's Civil Rule 82 which allows the winner of certain civil cases to recover a proportion of their legal fees from the loser.²⁷ The authors of the study were unable to draw strong conclusions about whether fee shifting affected the rates of case filings, and that although there seemed to be a higher rate of tort cases going to trial, the authors were not willing to attribute this to fee shifting.

²² H M Kritzer, *Lawyer Fees and Lawyer Behaviour in Litigation: What Does the Empirical Literature Really Say?* (December 2001), p 16.

²³ (June 1982) 11 *Journal of Legal Studies* 2, pp 225-251.

²⁴ See C E Epp *The Rights Revolution: Lawyers, Activists and Supreme Courts in Comparative Perspective* (1988); K O'Connor and L Epstein "Bridging the Gap Between Congress and the Supreme Court: Interest Groups and the Erosion of the American Rule Governing Awards of Attorneys' Fees" (1985) 38 *Western Political Quarterly* 238.

²⁵ See C Harlow and R Rawlings *Pressure Through Law* (1992).

²⁶ G Fournier and T W Zuehlke, "Litigation and Settlement: An Empirical Approach" (1989) *Review of Economics and Statistics* 189.

²⁷ Summarised in S Di Pietro "The English Rule at Work in Alaska", (1996) 80 *Judicature* 88.

Because the litigation stakes are higher under the UK rule, there is more risk attached to the outcome of the case. Accordingly, risk averse parties will file fewer cases, settle sooner and accept smaller settlement amounts under the UK rule than under the US rule. In other words, risk aversion can reverse some of the results mentioned above.

- 1.36 Coursey and Stanley's experimental study simulating litigation settlement bargaining, found that the UK rule led to more settlement than the US.²⁸ This was thought to be due to risk aversion (ie the higher risk of paying the opponent's costs under the UK rule encouraged settlement). Bevan, Fenn and Rickman sought to explain the stronger role of risk aversion, and the increased vulnerability of parties with weak cases under the UK rule, found by Coursey and Stanley, as compared with Snyder and Hughes's results:

First, Coursey and Stanley do not allow weak parties to drop their case (and thereby avoid future costs). This means that they must face the full effect of the inter partes cost risk under the UK rule. Plaintiffs in the other two papers have this option to drop the case. Second, bargainers in Coursey and Stanley are further exposed to costs because they have no agent to shift some risk to. In contrast, many plaintiffs in Hughes and Snyder's papers will have been advised by an attorney on contingent fees and will, therefore, have received some measure of insurance against the costs risk they face.²⁹

- 1.37 M R Baye, D Kovenock and C G de Vries "Comparative Analysis of Litigation Systems: An Auction-theoretic Approach",³⁰ also argued that settlement is more prevalent under the UK and Continental rules than the US and Quayle rules.
- 1.38 A Klement and Z Neeman "Against Compromise: A Mechanism Design Approach".³¹ This paper attempted to look at both procedural and substantive considerations in the search for an optimal procedural mechanism. Where a risk neutral plaintiff sues a risk neutral defendant (who knows whether or not he is liable), and the amount of damages is not in dispute, the UK rule minimises the rate of litigation subject to maintaining deterrence.
- 1.39 Aoki and Hu agreed with Hughes and Snyder that if both parties are more risk averse settlement would be possible for the same litigation costs, when it is not possible if the parties are more risk averse.³²

²⁸ D Coursey and L Stanley, "Pre-Trial Bargaining Behaviour Within the Shadow of the Law: Theory and Experimental Evidence" (1988) 8 International Review of Law and Economics, 161.

²⁹ G Bevan, P Fenn and N Rickman, Contracting For Legal Services With Different Costs Rules (March 1998), Lord Chancellor's Department Research Series 3/98, p 41.

³⁰ (July 2005) 115 Economic Journal, 583-601.

³¹ (2005) 21 Journal of Law, Economics and Organization 2, p 285.

³² (August 1996) econwpa.wustl.edu/eps/io/papers/9612/9612001.pdf.

- 1.40 Access to justice concerns are sometimes raised about precisely who the UK rule may discourage from litigating. Kritzer interviewed corporate lawyers and officials in Ontario in 1982, asking about the perceived impact of fee shifting.³³ His respondents thought the UK rule encouraged settlement by corporate defendants and discouraged corporate plaintiffs from suing. It was perceived to discourage individual claimants and encourage them to accept smaller settlements than they might expect at trial: the respondents saw individual litigants as risk averse. Some lawyers qualified this by noting that for individuals with no assets, the threat of having to pay the other side's costs was empty: "litigation is the sport of the very rich or the very poor".
- 1.41 In the Alaska study cited by Kritzer, comparative statistical data under the "US rule" was unavailable, but judges and lawyers were interviewed. They reported the following:
- (1) Only 35% of lawyers could recall even a single case in which Rule 82 played a significant role in a prospective client's decision not to file a suit or assert a claim. This was partly because many individual plaintiffs were judgment proof and couldn't pay even if costs were awarded against them: clients with assets were more likely to be risk averse as they had something to lose. Individuals of modest means and corporations of substantial means were not worried by the rule. Any perceived effect was associated with weaker or more subjective claims.
 - (2) About 1/3 of lawyers reported that Rule 82 affected their litigation strategy, typically as to choice of state or federal court, post trial strategy or formal settlement offers which could shift the fee-shifting burden.
 - (3) Each lawyer was asked to describe 2 recent cases, and then asked whether Rule 82 affected their settlement strategy in either. Only 37% reported impact on settlement strategy. The rule was seen as increasing the value of a case when the defendant's liability was clear and the dispute was over quantum not liability. In 4 cases described, Rule 82 increased the settlement value beyond the insurance policy limit. Only one plaintiffs' lawyer recalled any specific situations where clients "with assets" who had good claims settled for less than the claims were worth out of a concern about a Rule 82 award.
 - (4) Some lawyers believed that Rule 82 created an incentive to settle earlier. In strong cases, it reduces the incentive of the defence to drag the case out, particularly where damages were significant. Defence lawyers reported that the threat of a Rule 82 award was a good device to get a plaintiff with a weak case to accept an early settlement offer.
 - (5) The lawyers reported a number of cases in which an appeal was foregone in return for a waiver of legal fees.

Kritzer comments that to the extent that factors such as the strength of case and the litigants' assets distinguish among cases,

³³ H M Kritzer, "Fee Arrangements and Fee Shifting: Lessons from the Experience in Ontario", (1984) 47 Law and Contemporary Problems, 125.

“the affects (sic) described by the attorneys have a significant likelihood of actually being there. For the other findings, such as forum selection or post-trial settlement, the significance of the purported affects (sic) are less clear”.

Effects of payment into court and other offer-dependent fee shifting rules

1.42 A number of theoretical models have specifically considered the effects of rules that limit the successful plaintiff’s recovery of costs from the losing defendant where the judgment amount does not exceed the amount of the defendant’s earlier settlement offer or payment into court. There appears to be no consensus as to whether such rules increase or decrease the likelihood of settlement, even when similar assumptions are made. Theoretical models include:

- (1) Cooter, Marks and Mnookin, “Bargaining in the Shadow of the Law”, which concluded that their model confirmed the common belief that offers to compromise reduce the frequency with which suits end in trial³⁴.
- (2) K Spier, “Pre-trial bargaining and the design of fee-shifting rules”, a theoretical paper which showed that if the litigants are asymmetrically informed about the merits of the case, fee-shifting rules based on settlement offers made before the trial have powerful incentive properties. They decrease the likelihood of settlement where the parties have different information about the plaintiff’s probability of succeeding at trial (ie about liability) but increase the likelihood of settlement where the parties have different information about damages but agree on liability. The fee shifting rule that leads to the highest probability of settlement is one where either litigant may be penalised for rejecting a more favourable offer prior to trial.³⁵
- (3) A Farmer and P Pecorino, “Conditional Cost Shifting and the Incidence of Trial: Pre-trial Bargaining in the Face of a Rule 68 Offer”.³⁶ In contrast to Spier, they found that the payment into court rule reduces the incidence of trial, as compared with the US rule, even where the asymmetry of information relates to the probability of the plaintiff succeeding on liability (not just on quantum). This model included a round of bargaining after an offer of judgment has been made. Increasing the costs which could be shifted by a pre-trial offer (eg to include lawyers’ fees as well as court fees) has an ambiguous effect on the incidence of trial.

1.43 There have also been experiments on the effect of such rules:

³⁴ “Bargaining in the Shadow of the Law” (June 1982) 11 Journal of Legal Studies 2, pp 225-251.

³⁵ (1994) Rand Journal of Economics 25, pp 197-214.

³⁶ (2000) 2 American Law and Economics Review 2, pp 318-341.

- (1) B G M Main and A Park in “The impact of defendant offers into court on negotiation in the shadow of the law: experimental evidence”,³⁷ found that the introduction of offer-dependant cost-shifting rules makes little or no difference to the propensity to settle. However, the rule did slightly lower the size of the agreed settlements, thus favouring the defendant. They made no allowance for risk aversion or asymmetric information (ie where the plaintiff and defendant have different information about the plaintiff’s probability of succeeding at trial).
- (2) Kritzer cited two experimental studies which found that incorporating a fee shift into a formalised settlement offer increased the maximum defendants were willing to pay and reduced the minimum the plaintiffs were prepared to accept, potentially increasing the likelihood of settlement.³⁸

Costs and tribunals

- 1.44 Blandy et al’s study of the new (service charge and insurance) Leasehold Valuation Tribunal jurisdictions found that of the 349 lessees in the postal survey, 253 had at least one problem relevant to the new jurisdiction, of whom 191 had not submitted a case to an Leasehold Valuation Tribunal. 132 (69%) had considered making an application at one time or another: 36% gave uncertainties about the cost as a reason for not approaching the tribunal while 25% said they could not afford the costs.³⁹ The research showed that the costs involved in pursuing a case can serve as a barrier when the sum of money in dispute is relatively small and the likely financial gain minimal. Leaseholders and freeholders talked about undertaking impromptu cost-benefit analyses, either before applying or upon realising the likely impact on their purse. This kind of calculation was particularly pertinent in service charge cases, where a specific sum of money was in dispute.⁴⁰
- 1.45 Blandy et al comment that:

³⁷ (August 2002) 22 International Review of Law and Economics 2, pp 177-192.

³⁸ The studies are summarised in T D Rowe and D A Anderson, “Empirical Research on the Success of Settlement Devices” in D A Anderson, *Dispute Resolution: Bridging the Settlement Gap* (1996).

³⁹ S Blandy, I Cole, C Hunter, D Robinson, R Inniss and S Kane, Leasehold Valuation Tribunals: Extending the Remit – Analysis of appointment of a manager, insurance disputes and service charges cases before Leasehold Valuation Tribunals (January 2001), Department of the Environment, Transport and the Regions, pp 11-12.

⁴⁰ S Blandy, I Cole, C Hunter, D Robinson, R Inniss and S Kane, Leasehold Valuation Tribunals: Extending the Remit – Analysis of appointment of a manager, insurance disputes and service charges cases before Leasehold Valuation Tribunals (January 2001), Department of the Environment, Transport and the Regions, p 8.

One of the perceived advantages of the LVT over the County Court is that the losing party is not at risk of having to pay the other side's costs. This should, in theory, make pursuing a case less of a risk. Two of the leaseholders involved in the case study disputes said that they had harboured concerns about the reasonableness of service charges and the management of the property for some years but had not pursued their case through the courts because of the risk of having to pay costs. These leaseholders noted that the new jurisdiction of LVTs under the 1996 Housing Act finally allowed them to pursue their concerns in a cost effective manner.

A number of professional representatives recommended, however, that Leasehold Valuation Tribunals should be given powers to award costs, in order to prevent frivolous claims and to allow both parties to be represented:

... many landlords are in the advantageous situation of effectively being able to recover their costs through a service charge under the lease, even though LVTs cannot award costs. Leaseholders, however, can apply for an order to prevent the freeholder transferring costs incurred at the Leasehold Valuation Tribunal onto service charges, under the Landlord and Tenant Act 1985, s 20C. Among respondents to the postal survey, a higher proportion of those who had applied to the LVT (68 per cent) were aware of the right to apply for a section 20C order than the proportion aware of the possibility of waiving fees. Leaseholders will not, however, know the outcome of any such application until the end of the case since the LVT does not judge on section 20C applications until making the determination. Some applicants might be unwilling to take the risk. One professional representative suggested that too few leaseholders fully appreciated the risk that they were actually taking and argued that the grounds for making section 20C orders should be made more explicit.

...Aware of the barriers that costs present to many potential applicants and respondents, professional representatives offered a number of suggestions for reform, including a fee structure comparable with the courts, enforcing payment of fees by the losing party, and attempting to resolve dispute without recourse to the full LVT procedure.

The application fee could be paid by the losing party. This would be one way of getting the show on the road, and provide a sanction for unreasonableness. Awarding professional costs would be a disincentive to taking a case, too much of a risk. (Solicitor representing leaseholder).⁴¹

⁴¹ S Blandy, I Cole, C Hunter, D Robinson, R Inniss and S Kane, Leasehold Valuation Tribunals: Extending the Remit – Analysis of appointment of a manager, insurance disputes and service charges cases before Leasehold Valuation Tribunals (January 2001), Department of the Environment, Transport and the Regions, pp 17-19.

- 1.46 In *Staghold Ltd v Takeda*, a decision in the Central London County Court on 8 August 2005,⁴² Judge Levy QC held that the terms of the lease enabled the landlord to recover the legal costs of successful proceedings before the Leasehold Valuation Tribunal from its tenants by way of a service charge. Schedule 12 to the Commonhold and Leasehold Reform Act 2002 includes enabling powers under which regulations may be made providing for the Leasehold Valuation Tribunal to award costs against a party in certain circumstances. Paragraph 10(4) of that Schedule provides that:

A person shall not be required to pay costs incurred by another person in connection with proceedings before a leasehold valuation tribunal except by a determination under this paragraph or in accordance with provision made by any enactment other than this paragraph.

The judge held that this Schedule did not preclude a landlord from recovering those costs under a clause in the lease relating to service charges. The Leasehold Valuation Tribunal had refused to make a section 20C order in respect of the costs of the proceedings in this case.

- 1.47 The Leggatt Review commented on the issue of costs in tribunals:

4.40 Since Franks the general rule has been that tribunals should not normally have the power to award the costs of representation. There are exceptions, such as in employment and tax tribunals. Some who responded to our consultation were not in favour of tribunals having general powers to award costs; it could be a significant deterrent to some appellants pursuing what appears to be an arguable case. Some respondents thought it was appropriate for tribunals to have such power in cases where the tribunal process was abused or where one party behaved unreasonably to such an extent that additional expense was incurred for the other party, including the state. Others contended that tribunals should have power to award costs. There was an argument that, where representation was the norm, appellants who succeed in their actions against the state should not have to bear their own costs. No evidence was presented to suggest that the state would seek costs orders. On the arguments put before us we are not persuaded that further extension to tribunals' costs powers is necessary. [58]

⁴² Unreported, but available on Lawtel LTL 1/9/2005, Document No. AC0109528.

4.41 In the particular case of (ETs) there was significant argument over the extent to which costs should follow the event, particularly as a deterrent to an increasing volume of cases perceived as frivolous or vexatious. This was also seen as an issue in SENT. The DTI intends lifting the ceiling on costs which the Tribunals can currently award and has introduced other measures designed to weed out mischievous, misconceived or non-meritorious cases. As our note on ETs records, we suggest that this issue merits further investigation.⁴³

⁴³ Tribunals for Users One System, One Service – Report of the Review of Tribunals by Sir Andrew Leggatt (2001) Department for Constitutional Affairs.