Reforming The New Discovery Rules

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Reform of discovery rules should both internalize and equalize discovery costs. Internalizing discovery costs eliminates abuse and promotes efficiency. Equalizing discovery costs eliminates distortions in bargaining power between the parties and promotes fairness. We propose a cost-shifting rule that can achieve both objectives while reducing the administrative burden on judges. Our two-part rule derives from an economic definition of discovery abuse and an analysis of incentive effects of discovery rules. We show that our theory can be used to interpret as well as critique existing discovery rules and the recent reforms of those rules.

I. INTRODUCTION

The laws of procedure for state and federal courts in the United States permit each side in a dispute to submit pretrial questions to the other party, interview the other side's witnesses under oath, requisition documents, and inspect physical objects in dispute. Failure to respond fully and candidly to information requests can trigger a variety of sanctions by the court. Discovery ideally informs each side about the facts upon which the other party's legal arguments are based. In practice, however, parties sometimes abuse discovery and impose unnecessary costs on each other. The gap between the ideal outcome and reality has provoked a long history of controversy and a variety of proposed reforms. The newest reforms of the Federal Rules of Civil Procedure mark the latest step in that history.

In an earlier article, we developed a framework for evaluating the fairness and efficiency of discovery rules.[1] Our framework provides a precise definition of "discovery abuse" and a clear prescription for its remedy. In this article, we apply our framework to the latest changes in the discovery rules and conclude that these changes are likely to have little effect on the fairness and efficiency of the discovery process. We believe, however, that a more comprehensive reform effort, which is consistent with the spirit of the new discovery rules, can improve the process significantly.

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1. Robert D. Cooter & Daniel L. Rubinfeld, *An Economic Model of Legal Discovery*, 23 J. LEGAL STUD. 435 (1994).

ery costs. Internalizing discovery costs eliminates abuse and promotes efficiency. Equalizing discovery costs eliminates distortions in bargaining power between the parties and promotes fairness. We propose a cost-shifting rule that can achieve both objectives while reducing the administrative burden on judges. Our two-part rule derives from an economic definition of discovery abuse and an analysis of the incentive effects of discovery rules. We show that our theory can be used to interpret as well as critique existing discovery rules and the recent reforms of those rules. To implement our proposal, we recommend that courts require mandatory disclosure, as well as cost-shifting for discretionary discovery above a minimal, statutorily-limited number of discovery requests.

Following this introduction, Part II defines discovery abuse and explains how current law creates incentives for it to occur. Part III proposes a cost-shifting rule that would eliminate abuse, promote fairness, and reduce the administrative burden on judges who must supervise discovery. Part IV discusses the recent reforms of discovery rules, especially mandatory disclosure, and concludes that they will not eliminate abuse. Part V evaluates the potential practical problems with implementing our cost-shifting rule. Part VI concludes briefly.

II. DISCOVERY ABUSE

A. ECONOMIC DEFINITION OF AN ABUSIVE DISCOVERY REQUEST

We begin by narrowly defining an abusive discovery request.[2] Both sides in a two-party dispute attach an expected value to pursuing a legal claim.[3] The plaintiff, who expects to benefit from the suit, attaches a positive expected value; in contrast, the defendant, who faces possible liability, attaches a negative expected value. The expected value depends on the possible outcomes of the suit and the cost of reaching them. An increase in

2. For commentary on the uses and abuses of discovery, see Wayne D. Brazil, *Views from the Front Lines: Observations by Chicago Lawyers About the System of Civil Discovery*, 1980 AM. B. FOUND. RES. J. 217 [hereinafter Brazil, *Front Lines*]; Frank H. Easterbrook, *Comment: Discovery as Abuse*, 69 B.U. L. REV. 635 (1989); Geoffrey C. Hazard, Jr., *Discovery Vices and Trans-Substantive Virtues in the Federal Rules of Civil Procedure*, 137 U. PA. L. REV. 2237 (1989); David L. Shapiro, *Some Problems of Discovery in an Adversary System*, 63 MINN. L. REV. 1055 (1979); Note, *Discovery Abuse Under the Federal Rules: Causes and Cures*, 92 YALE L.J. 352 (1982).

3. At a minimum, the plaintiff's expected value in a particular case will be a function of the probability that the plaintiff will receive a settlement, the amount of the settlement, the probability that the case will go to trial, and the expected amount of the trial award. However, the expected value may also depend on the risk associated with the case, and the effect that the case will have on future claims. (For example, if a plaintiff victory at trial increases the likelihood that future claims will be made, the defendant may be more willing to settle, thereby increasing the plaintiff's expected outcome.) To simplify the analysis, we do not consider the more complex rules for allocating discovery costs in cases involving multiple parties.

the expected value of pursuing a legal claim consists either of an increase in the plaintiff's expected benefit or a decrease in the defendant's expected cost.

A party typically makes a discovery request in order to obtain new information that it hopes will increase the expected value of pursuing a legal claim.[4] In order to promote efficiency, however, the increase in expected value must be balanced against the cost of discovery. The cost of discovery includes both the cost of making the request and the cost of complying with it. Making a request requires formulating it, possibly deposing witnesses or visiting premises, and digesting the response. Complying with a request requires interpreting it, gathering appropriate information, tailoring a response, and delivering it.

We define an abusive discovery request by comparing the benefits to the requesting party and the costs to both parties.[5] *An abusive discovery request occurs when request and compliance costs exceed the increase in the expected value of the requesting party's claim.* In other words, abuse results when the requesting party gives less weight to the other party's costs of compliance than it gives to its own costs and benefits.

To illustrate, assume that the plaintiff and defendant dispute the ownership of an automobile worth $5000.[6] The plaintiff wants to build his case by obtaining some specific information from the defendant. The plaintiff expects that the information will increase the probability of him gaining the automobile by settlement or trial from .5 to .6. Thus, the expected increase in the value of the plaintiff's legal claim caused by the request for specific information equals $500.[7] The plaintiff's requesting costs and the defendant's compliance costs must be added to obtain the total cost of discovery. Assume that the plaintiff's cost of requesting the specific information equals $50. If the defendant's cost of producing the requested information is *less* than or equal to $450, then discovery has *not* been abused. If the defendant's cost of producing the requested information is *greater* than $450, then discovery *has been* abused.

Our definition of abuse is intuitive when the party requests information

4. It is possible, of course, that the requesting party will be unpleasantly surprised by the discovery response; even in this case, however, the expected value may increase. For example, becoming aware of information that will ensure a defendant victory at trial will allow a plaintiff to drop a case before incurring substantial litigation costs.

5. Ideally, abuse should be determined on an item-by-item basis. In Part IV, we suggest that for practical reasons cost-shifting may best be accomplished on a case-by-case basis.

6. This example assumes that the value of a winning suit remains constant regardless of what information is discovered. A more complex situation would arise if the value depended on the outcome of the discovery process. For example, unlike a dispute over the ownership of a $5000 automobile, the value of many tort suits depends on the degree of wrongdoing. Jury verdicts that award unexpected punitive damages, for instance, demonstrate how information found during discovery not only changes the probability of winning, but also may alter the pay-out if victory occurs.

7. $500 = $5000 × (.6 − .5).

to strengthen its case. For example, the plaintiff may request information expected to increase the probability and extent of a favorable judgment, or the defendant may request information expected to decrease the probability and extent of a favorable judgment to the plaintiff. However, our definition also applies in the counterintuitive case where the party requests information that may weaken its case. By requesting such information, the requesting party hopes to avoid wasting money on unsuccessful litigation. To illustrate, assume the plaintiff thinks that his litigation costs will be $1000 if he goes to trial. Winning or losing depends upon the truth of a proposition known to the defendant. The probability that the proposition is true equals .5. By requesting the fact, the plaintiff expects to save $500 in litigation costs.[8] Therefore, as long as the costs to the parties of requesting and providing the information do not exceed $500, the request should be pursued.

B. CURRENT LEGAL DEFINITIONS

Under current law, the court determines whether discovery abuse has occurred. Rule 26 of the Federal Rules of Civil Procedure creates a two-pronged test for identifying discovery abuse. First, a party must answer questions reasonably calculated to have material bearing on the case.[9] Second, answering the questions must not impose an undue burden or expense on the complying party.[10] This two-pronged test applies ex ante when a judge decides whether a party must comply with a discovery request. The test also applies ex post when a judge decides whether discovery abuse has occurred.

Material bearing and undue burden are not well-defined concepts in current law. Applying our definition of discovery abuse to Rule 26 provides a clear interpretation of the two-pronged test for most cases. According to our definition, the first prong of the test requires discovery to increase the expected value of the requesting party's legal claim. In other words, we interpret "material bearing" to mean "change in expected value of the claim." We interpret "undue burden" in the second prong as a balancing test, requiring the increase in the value of the requesting party's claim to exceed compliance costs. In other words, discovery is abused if the ex-

8. If the plaintiff does not request this fact, he expects to lose $500 (= $1000 x .5) in litigation costs.

9. Thus, Rule 26(b)(1) states in part that "[p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action." FED. R. CIV. P. 26(b)(1).

10. According to Rule 26(b)(2), "discovery . . . shall be limited . . . if . . . (iii) the burden or expense of the proposed discovery outweighs its likely benefit, taking into account the needs of the case, the amount in controversy, the parties' resources, and the importance of the proposed discovery in resolving the issues." FED. R. CIV. P. 26(b)(2).

pected value of the information to the requesting party, net of the cost of requesting it, is less than the cost of compliance.

C. INCENTIVES FOR ABUSE UNDER EXISTING LAW

The current rules of civil procedure in the United States provide strong incentives for abusive discovery requests by both plaintiffs and defendants. To understand why, consider the extent to which a rational party will engage in discovery.[11] The requesting party will conduct additional discovery as long as the cost to her falls short of the expected increase in the value of her legal claim. Two factors greatly reduce the costs of discovery to the requesting party. First, requesting information costs little compared to the cost of compliance. Second, under the current rules of civil procedure, the complying party pays part or all of the cost of complying with the discovery request.

In her calculation of total compliance costs, the rational, self-interested requesting party does not consider the cost of compliance. Thus, the rational requesting party will request information that increases the expected value of her legal claim by a little, even though compliance costs the other party a lot. To illustrate using the preceding example of the disputed automobile, the plaintiff decides whether to request specific information by comparing the expected increase in the value of her claim, which equals $500, to the cost of making the request, which equals $50. Under the current rules of discovery, the plaintiff does not consider the defendant's cost of compliance, which may exceed $450.

Assume further that the plaintiff can request additional information that costs the defendant $100 to produce, and which will increase her probability of winning $5000 from .600 to .601. The discovery request increases the expected value of the plaintiff's legal claim by $5,[12] at a compliance cost to the defendant of $100. Again, the request satisfies our definition of discovery abuse because the increase in the expected value of the legal claim ($5) does not exceed the cost of compliance ($100).

This example shows that externalizing part of the cost of compliance creates incentives for abusive discovery requests. Compliance costs are externalized when borne by the complying party rather than the requesting party. As long as the complying party bears part of the cost of compliance, the requesting party has an incentive to make inefficient, abusive discovery requests. The problem affects both plaintiffs and defendants because both externalize the cost of compliance to the complying party.

The parties can avoid wasteful discovery by agreeing to restrain it. However, inability to cooperate often causes the parties to proceed to litigation in the first place, rather than settle their dispute. If the parties

11. Though this section assumes the plaintiff is the requesting party, the analysis would apply equally to a defendant who requests information through discovery.

12. $5 = .001 x $5000.

cannot agree to limit discovery, the incentives created by the current rules guarantee that each party will make abusive requests.

D. EVIDENCE OF ABUSE

Our analysis of legal incentives predicts that abusive discovery requests will occur often. In fact, researchers who look for abuse apparently have no trouble finding it. The scholarly literature contains numerous impressions by experienced practitioners and limited data on the discovery process.[13] Magistrate Judge Wayne Brazil and others have found that "overdiscovery" is a pervasive problem.[14] According to Brazil, "[m]any larger case litigators complained that much of the information requested by opposing parties is either wholly irrelevant to matters in dispute or of only marginal utility."[15] In addition, Brazil reports that lawyers believed "only a small percentage of the information that their own discovery efforts produce is really useful."[16] Brazil concludes:

> [V]irtual consensus [exists] among larger case lawyers that the discovery system as they experienced it would not fare well in a rigorous cost-benefit analysis: many such lawyers apparently believe that the expense the process generates is often disproportionate to the value of the information it yields.[17]

According to Brazil's research, attorneys working on larger cases complained most frequently about "overdiscovery." The complaints about overdiscovery increased for cases in federal court, antitrust cases, and cases involving corporate clients.[18] Discovery requests were sometimes used for purposes other than obtaining information to prepare for trial. For example, discovery requests have reportedly been used "to exert economic pressure on a competitor, to uncover trade secrets, or to acquire information from an unwary nonparty in order to lay the foundation for a subsequent action against it."[19]

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13. For a list of all articles containing empirical data on discovery as of 1988, see Laurens Walker, *Perfecting Federal Civil Rules: A Proposal for Restricted Field Experiments*, LAW & CONTEMP. PROBS., Summer 1988, at 67, 69 n.7. *See also* Laurens Walker, *Avoiding Surprise From Federal Civil Rule Making: The Role of Economic Analysis*, 23 J. LEGAL STUD. 569 (1994) (surveying studies that apply an empirical or economic approach to analyzing discovery rules).

14. *See, e.g.*, Wayne D. Brazil, *Improving Judicial Controls over the Pretrial Development of Civil Actions: Model Rules for Case Management and Sanctions*, 1981 AM. B. FOUND. RES. J. 873, 880-81 [hereinafter Brazil, *Model Rules*]; Wayne D. Brazil, *Civil Discovery: Lawyers' View of Its Effectiveness, Its Principal Problems and Abuses*, 1980 AM. B. FOUND. RES. J. 787, 871 [hereinafter Brazil, *Civil Discovery*]. *See generally* JOSEPH L. EBERSOLE & BARLOW BURKE, FEDERAL JUDICIAL CENTER, DISCOVERY PROBLEMS IN CIVIL CASES 18-29 (1980) (recounting numerous reports of overdiscovery in a variety of contexts).

15. Brazil, *Front Lines*, *supra* note 2, at 230.

16. *Id.*

17. *Id.* at 234.

18. Brazil, *Civil Discovery*, *supra* note 14, at 831.

19. Brazil, *Model Rules*, *supra* note 14, at 881.

The available evidence, which is impressionistic rather than systematic, supports our view that the current law causes excessive discovery. Excessive discovery, however, is not the only reported problem. Evasion of discovery requests can lead to important facts remaining undiscovered. Brazil reports "evasive or incomplete responses" and "extended delay" in responding to discovery requests by some parties.[20] A 1978 Federal Judicial Center study reported that, with a majority of discovery requests, complying parties do not comply before the thirty-day deadline for compliance expires.[21] Even so, motions to compel are not usually filed; presumably the parties come to some mutual agreement without relying on the court, or else the cost of filing a motion to compel exceeds its expected value.[22] The study concludes that the enforcement mechanism designed to avoid delay does not function adequately.[23] Another study by Joseph Ebersole and Barlow Burke also found resistance to discovery, especially document production.[24]

Does the discovery process fail to encourage parties to reveal important and valuable information? Wayne Brazil reports an information disparity in complex cases: In about fifty percent of the larger, more complex cases that are resolved by settlement, at least one party believes it knows something significant about the case that the other party's counsel has not discovered.[25] For cases that go to trial, the comparable figure is thirty percent.[26] This information disparity typically occurs in large cases, antitrust cases, and federal cases.[27] These observations demonstrate that discovery does not result in complete revelation of information by both parties, a result consistent with the underlying economic incentives and inconsistent with the stated purpose of discovery.

Does a disparity in information persist because of the costs of discovery? In one survey, attorneys in twenty percent of cases cited the "cost of pursuing information" as a factor that "could make [an attorney's] discovery more difficult or could account for [an attorney] not discovering or not pursuing some information."[28] Cost was more likely to be a factor for small

20. Brazil, *Civil Discovery*, *supra* note 14, at 827-30.

21. *See* PAUL R. CONNOLLY ET AL., FEDERAL JUDICIAL CENTER, JUDICIAL CONTROLS AND THE CIVIL LITIGATIVE PROCESS: DISCOVERY 18 (1978) (reporting that 80% of responses to interrogatories and 60% of responses to document requests exceeded thirty-day limit).

22. *Id.* at 19-20 (concluding that motions to compel late responses are only filed in 18.2% of interrogatory requests and 62.8% of document requests).

23. *See id.* at 23-26 (arguing that motions for sanctions are filed so infrequently that they provide no incentive for prompt responses). There is little direct discussion about using discovery tactics to compel settlement (although the topic is clearly related to resistance, delay, and harassment, which are discussed). For one reference, see William H. Speck, *The Use of Discovery in the United States District Courts*, 60 YALE L.J. 1132, 1152 (1951).

24. EBERSOLE & BURKE, *supra* note 14, at 13-16.

25. Brazil, *Civil Discovery*, *supra* note 14, at 811, 813.

26. *Id.* at 815.

27. *Id.* at 812.

28. *Id.* at 833.

cases (twenty-five percent) than for large cases (eighteen percent).[29] Brazil sees the "cost" factor as being important in a "surprisingly low" number of cases.[30] We find it less surprising, however, because the requesting party has little reason to be concerned with most compliance costs borne by the complying party.

Little evidence exists concerning the ability of judges to curtail discovery abuse. One study found that judges who actively supervise discovery shorten the discovery and disposition time but not the amount of discovery requested.[31] Even if more aggressive judicial control over the discovery process could curtail abuse, most judges and magistrates do not take an active role in the process. The bar apparently does not oppose a more active judicial involvment in the discovery process. Brazil found that fifty-nine percent of attorneys (eighty percent of attorneys in large, complex cases) desired judges to assume a greater role in the discovery process.[32] Around eighty to ninety percent of lawyers "welcomed more aggressive use of the sanctioning power."[33] Those who were hesitant, however, noted that the sanctioning process was "arbitrary and unpredictable."[34]

Overall, Brazil found that attorneys have a low opinion of the current role of judges in discovery. Attorneys reported that judges responded to discovery conflicts with "an air of undisguised condescension, impatience, or open hostility—implying that involvement in these kinds of disputes is either beneath their dignity or an unjustifiable intrusion on their time."[35] In addition, many attorneys complained that the judges' rulings often appear "to be little more than preprogrammed responses which reflect deeply ingrained biases" either for or against discovery.[36] Moreover, attorneys also reported that "magistrates are woefully underequipped in talent, time, and temperament."[37] In sum, sixty-nine percent of attorneys reported that they obtained insufficient aid from the court in resolving discovery conflicts.[38] These findings support our contention that judges are poorly situated to make the decisions regarding discovery currently required of them by the Federal Rules of Civil Procedure.

III. A COST-SHIFTING PROPOSAL

This Part explains how our definition of an abusive discovery request can be used to clarify and reform the discovery rules.

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29. *Id.*
30. Brazil, *Civil Discovery*, *supra* note 14, at 839.
31. *See* CONNOLLY ET AL., *supra* note 21, at 52.
32. Brazil, *Civil Discovery*, *supra* note 14, at 863-64.
33. *Id.* at 865-66.
34. *Id.* at 866.
35. Brazil, *Front Lines*, *supra* note 2, at 245-46.
36. *Id.* at 246.
37. *Id.*
38. *Id.* at 247.

A. COST-SHIFTING: A BETTER REFORM

Under current law, a finding of discovery abuse must be made in order to establish liability and shift the full cost of compliance. To determine whether a request for discovery was abusive, the court must estimate and compare the costs and benefits of the request. Making such a comparison requires courts to estimate how much the requested information increased the expected value of the legal claim. Because the expected value of the claim depends on a variety of tangible and sometimes intangible factors, the courts usually lack the information and resources needed for such a computation.

Fortunately, such an exercise in judicial management is not required to improve the fairness and efficiency of the discovery process. Instead, courts could routinely shift the cost of compliance to the requesting party, even when no proof of abuse exists. Shifting the cost of compliance forces the requesting party to internalize the costs borne by both parties when deciding whether to make a discovery request. In this way, cost-shifting eliminates the incentives for abusive discovery requests while not requiring judges to determine case-by-case whether discovery abuse has occurred.

For example, assume that a plaintiff, who requests information that costs the defendant $100 to produce, is required by law to pay that amount to the defendant. Due to cost-shifting, the requesting party will internalize the $100 cost of compliance. Consequently, the plaintiff will not request information that costs $100 to produce unless he believes the expected value of his legal claim will increase by at least $100. Under such a cost-shifting rule, the rational plaintiff will request additional information until the resulting increase in the expected value of his legal claim equals the cost of making the request and complying with it. In general, therefore, cost-shifting eliminates abusive discovery requests by forcing the requesting party to internalize the cost of compliance.

An analogy to the difference between strict liability and negligence in tort law may help to clarify the point. Under a rule of strict liability the court must determine whether the defendant caused the plaintiff's harm. Accurate determinations cause potential injurers to internalize the risks that they impose on others. Internalization of risk causes potential injurers to balance the cost of precaution with the harm avoided by it, as required for economic efficiency. In contrast, under a negligence rule the court must determine whether the defendant complied with the legal standard of care. Accurate determinations cause potential injurers to comply with the legal standard in order to avoid liability. To provide incentives for efficient precaution, the court must set the legal standard at the level which balances the cost of precaution and the harm avoided by it.[39]

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39. *See generally* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 326-71 (1988) (explaining economic theory of torts).

A discovery rule that requires cost-shifting is similar to a rule imposing strict liability in torts. Accurate determination of compliance costs, like accurate determination of accident costs in tort law, causes injurers to internalize the costs that they impose on others, thereby eliminating discovery abuse. In contrast, the current rule of discovery, which shifts costs only after abuse is proved, is similar to a rule of negligence in torts. Accurate determinations of abuse, like accurate determinations of negligence in tort law, cause the requesting party to avoid abuse in order to escape liability. However, the court must balance the benefits and costs of the request in order to set the standard of abuse. Judges lack the information needed to strike this balance, so we favor a cost-shifting rule that relieves judges of this task. Under a rule of routine cost-shifting for discovery requests, the court need only determine the reasonable cost of compliance, but not the legal standard that distinguishes abusive from nonabusive requests. A rule of strict liability can provide incentives for potential injurers to take the appropriate level of care, so long as the court computes damages accurately.[40] Similarly, routine shifting of compliance costs can provide incentives for parties to make only nonabusive requests for information, as long as the court accurately measures the cost of compliance.

B. THE SWITCHING POINT

In litigation, some discovery requests are essential to a party's case and others are dispensable. Discovery requests that are essential will be made whether or not the party must bear the cost of making the requests, whereas dispensable requests may be forgone, depending upon who bears their costs. Just as economists call dispensable expenditures "marginal," and essential expenditures "non-marginal," we will refer to dispensable requests as marginal, and essential requests as non-marginal. In general, if the cost of making discovery requests increases, the requesting party will forgo some or all of its marginal requests, while retaining those that are non-marginal.

Essential discovery requests are not abusive as defined in this article. Because they are also non-marginal, they will be made regardless of whether or not compliance costs are shifted. In contrast, dispensable requests, which by definition are marginal, can be either abusive or nonabusive depending on the costs and benefits of the particular request. By shifting compliance costs to the requesting party the cost-shifting rule will deter abusive requests and not deter nonabusive requests. Thus, discovery abuse can be deterred by shifting the cost of complying with marginal requests, regardless of whether or not the law shifts the cost of complying with non-marginal requests. To eliminate the incentive for discovery abuse, the cost of complying with marginal discovery requests *must* be shifted to

40. *See generally id.* at 335-36 (discussing strict liability).

the requesting party, but the cost of complying with non-marginal discovery requests *need not* be shifted.

To illustrate, assume that the plaintiff has already made nine discovery requests, and the tenth request increases the expected value of the legal claim by $5 at a compliance cost of $100. Shifting compliance costs for the tenth discovery request will prevent the plaintiff from making it. This is true regardless of whether or not the cost of complying with the non-marginal discovery requests—i.e., the cost of the previous nine discovery requests—is shifted. If the ninth request increases the expected value of the legal claim by $150, at compliance cost of $100, then the request will be made regardless of whether or not the costs are shifted. In this example, the tenth request is marginal and the ninth request is non-marginal.

While shifting of compliance costs for marginal discovery requests eliminates the incentive for discovery abuse, shifting of costs for non-marginal discovery requests can address concerns of fairness and redistribution. In general, the allocation of compliance costs with non-marginal requests does not influence whether or not these requests are made, so these costs can be redistributed without changing discovery behavior. Specifically, the costs of compliance with non-marginal requests can be allocated to achieve goals of fairness or redistribution, without encouraging abusive discovery. For example, if legal policy aims to impose discovery costs on the complying party, then the cost of complying with non-marginal requests can be left where they fall. Conversely, if legal policy aims to impose discovery costs on the requesting party, then the cost of complying with non-marginal requests can be shifted from the complying party to the requesting party.

To achieve efficiency and distributive objectives, we propose a two-part cost-shifting rule. Under the rule, each party pays its own costs of discovery up to a level prescribed by law. For discovery requests beyond the prescribed level, the court shifts the reasonable cost of compliance to the requesting party. To illustrate with our example, assume that the law prescribes $600 for compliance with plaintiff's discovery requests, and assume that the court finds that compliance with the plaintiff's first seven requests costs $600. The reasonable costs of compliance will be shifted to the plaintiff for any additional requests after the seventh. Thus, the plaintiff's incentives for nonabusive discovery are preserved at the margin, but the plaintiff is relieved of the burden of bearing the costs of initial discovery.

1. Choosing a Switching Point

The recent discovery reforms have the effect of dividing discovery into two parts—mandatory and discretionary. This two-tiered system could serve as the basis for the introduction of a cost-shifting discovery rule. For example, the courts could continue to place the costs associated with

mandatory discovery (disclosure) on the party that provides the information, while shifting the cost of discretionary discovery requests to the requesting party. If mandatory discovery is essential and non-marginal, the allocation of compliance costs does not affect abuse. If discretionary discovery includes dispensable and marginal requests, the shifting of compliance costs will prevent abuse. As long as the parties make some discretionary discovery requests, shifting the compliance costs of those requests will internalize the cost of marginal discovery, thereby promoting efficiency.

In order to pursue the additional goal of fairness, the courts could adjust mandatory disclosure to equalize its costs to both parties. We consider cost-equalization to be fair in many cases. By equalizing mandatory disclosure costs and internalizing discretionary discovery costs, fairness and efficiency are preserved.

As explained, the distinction between mandatory and discretionary discovery could serve as a basis for cost-shifting. Alternatively, the current discovery requirements that set presumptive limits on the permissible number of interrogatories and depositions in a case could serve as the basis for another cost-shifting rule.[41] For example, perhaps the interrogated party would pay for the first twenty-five interrogatories, while the requesting party would pay for any additional interrogatories. This approach creates an incentive to reorder requests so that the most costly are made first. Even so, such a rule could provide a useful means of introducing cost-shifting and deterring abuse.

We have discussed two ways to impose a switching point for the allocation of compliance costs. In general, the choice of the switching point will not affect the efficiency of the cost-shifting rule, as long as two conditions are satisfied. First, the switching point must be set low enough so that the requesting party pays the compliance costs for *some* of its requests. This condition ensures that the requesting party internalizes the cost of the marginal discovery requests. Second, the rule for setting the switching point must be such that the parties to the dispute cannot change the switching point by altering the amount of their discovery. This condition prevents strategic manipulation of the procedural rule.[42]

To appreciate the problem of strategic manipulation, consider a rule that is susceptible to it. Assume that compliance costs will be shifted by the amount by which one party's compliance costs exceed one-half of the total compliance costs of both parties. For example, if each party's compliance costs equal $5000, then no compliance costs are shifted. If, however, one party makes an additional request so that complying with his requests now

41. Under the new rules, a party must get leave of the court for more than 10 depositions, FED. R. CIV. P. 30(a)(2), and 25 interrogatories, unless the other party voluntarily agrees. FED. R. CIV. P. 33(a).

42. See the discussion of moral hazard in Part IIIC2.

costs, say, $5100, whereas the other party continues to impose $5000 in discovery requests, then costs will be shifted. Specifically, total compliance costs equal $10,100 after the additional request, so half of the new total equals ($10,100/2) = $5050. Thus, the party making the additional request must pay $5100 − $5050 to the other party. It is not hard to see how this rule creates incentives for abuse. The party whose request imposes an additional $100 in compliance costs must pay $50. The requesting party will recognize that he pays only half of the costs of complying with his additional requests, so he will have an incentive for abuse.

We discussed setting the switching point based upon the mandatory-discretionary distinction in the new law, or upon numerical limits on interrogatories and depositions. A third alternative, which satisfies the conditions for an efficient switching point, would have the court calculate the switching point based on average values for similar cases in the past. Following this approach, the court would set the actual switching point for a current case below the average reasonable compliance costs for similar cases in the past. Rough estimates and rules of thumb should suffice to ensure that the switching point is set low enough to trigger some cost-shifting, thereby satisfying the first condition of efficiency. The second condition, that the parties should not be able to manipulate the switching point by altering the amount of their discovery, is met automatically because current litigants cannot influence the cost of past discovery.[43]

A fourth and final alternative is to set the switching point by statute. This approach removes the courts from determining the switching point, but it exposes the choice to politics. A variety of political and policy concerns could ultimately influence the determination of the switching point. Court determinations are likely to be case specific and therefore likely to involve substantial administrative costs. Statutorily determined switching points, however, are more sensitive to the lobbying efforts of political interest groups. In Part V, we suggest how the choice of the switching point can be tied directly to some of the recent reforms in the Federal Rules of Civil Procedure.

Practical objections can be raised to any concrete proposal to choose a switching point for cost-shifting. We should, however, apply the same critical standards to the existing rules as to our proposed reforms. Think of the existing rules, which do not provide for cost-shifting, as setting an arbitrarily high switching point that real cases never achieve. Such a switching point does not contribute to efficiency because the requesting party does not internalize any compliance costs. Therefore, any switching point that causes the requesting party to internalize some of the compliance costs provides more efficient incentives than the current rule. In

43. The analysis becomes more complicated when the litigation involves large, repeat players who can influence average costs over time.

addition, an arbitrarily high switching point does not contribute to fairness, because it makes no attempt to correct natural inequalities in discovery costs. Any switching point that shifts non-marginal discovery costs in a direction that reduces the natural inequalities in the current system promotes fairness. Therefore, we suggest that almost any cost-shifting rule, regardless of the switching point, will improve both the efficiency and fairness of the existing discovery rules.

2. Defining An Ideal Switching Point

We discussed four ways to implement a switching point. Now we turn from implementation to ideals. In a previous article, we proposed an ideal standard of fairness for setting the switching point, which provides a useful guide for developing legal policy.[44] According to our ideal, settlements should mimic judgments. A settlement mimics a judgment when the parties settle out of court for a sum of money equal to the expected judgment at trial.[45] When a settlement mimics the expected trial judgment, we conclude that the dispute is resolved on its legal merits.[46] In contrast, when a settlement fails to mimic the expected judgment, we believe that unequal bargaining power and the strategic manipulation of procedural rules have diverted the settlement away from the legal merits of the case. In general, a "fair settlement" mimics the expected judgment, and an unfair settlement does not.

A settlement will correspond to the expected trial judgment when the costs of resolving the dispute—commonly called transaction costs—are equal for the two parties.[47] Conversely, asymmetrical transaction costs distort the terms of settlement so that they do not correspond to the expected trial judgment. For example, if the plaintiff faces lower trial costs than the defendant, the plaintiff can demand more than the expected judgment to settle the case. Similarly, if the plaintiff faces lower discovery costs than the defendant, the plaintiff can demand more than the expected judgment to settle the case before discovery commences. Conversely, if the defendant faces lower discovery and trial costs than the plaintiff, the defendant can insist on settling for less than the expected judgment.

Ideally, the switching point should be set so that discovery does not

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44. *See* Cooter & Rubinfeld, *supra* note 1, at 455-57. We stress that the choice of a switching point and the particular values of fairness to be applied are open to judicial as well as political debate.

45. The expected trial judgment is determined prior to trial on the basis of all information known to both parties.

46. The analysis would be more complex if the parties varied in their attitudes towards risk or were repeat players who valued possible trial outcomes differently than one-time litigants.

47. This proposition can be formulated using the Nash bargaining solution. In game theory, the Nash bargaining solution to the settlement game equals the expected judgment when the transaction costs of dispute resolution are equal for both parties.

distort the settlement process. In order to reduce the possibility of distortion, the total discovery costs faced by the two parties should be roughly equal.[48] Consequently, other things being the same, the law should prescribe a switching point that ensures rough equality between the two parties' costs of discovery.[49]

For example, suppose the plaintiff has much to discover and little to reveal.[50] To be more concrete, assume that a plaintiff's reasonable discovery requests cause a defendant to spend $2000 in compliance costs, while the defendant's reasonable requests impose compliance costs of $1000 on the plaintiff. Now, set the switching point at $1500. The two-part cost-shifting rule would require the defendant to bear the costs of reasonable compliance up to a level of $1500, beyond which the reasonable costs of complying with further discovery requests would shift to the plaintiff. Thus, the plaintiff would pay $1000 responding to the defendant's request, plus $500 of the defendant's compliance costs, for a total of $1500. After receiving $500 from the plaintiff, the defendant would pay $1500 of the $2000 cost of responding to the plaintiff's requests. After partial cost-shifting, the net expenditures for discovery would be $1500 for each party, as required for equality.

In this example, each party can save the same amount—$1500—by settling prior to discovery, rather than settling after discovery. Because discovery costs are equal, their presence will not distort the process of bargaining to reach a settlement. Furthermore, each party internalizes the marginal cost of discovery as required for efficiency.

The two-part cost-shifting rule generally achieves two goals. First, the rule can make the requesting party bear the cost of marginal discovery, which eliminates the incentives for abuse. Second, the rule can make the complying party bear enough of his compliance costs to equalize them, which reduces distortions in settlement bargaining. In contrast, the more traditional rules ("each bears his own costs" or "all costs are shifted") result in discovery abuse or unfair settlements. A discovery rule that shifts *no* discovery costs ("each pays his own costs") encourages discovery abuse by both parties because they externalize the compliance costs. Alternatively, a rule that shifts *all* discovery costs (both marginal and non-marginal) imposes larger costs on the party with more to discover than to reveal, thereby distorting settlements.

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48. Ideally, all discovery, settlement, and trial costs should be roughly equalized. As long as discovery costs are not inversely related to other pretrial and trial costs, equalization of discovery costs will move total costs in the direction of equalization.

49. It would be impractical to choose a switching point that roughly equalizes costs on a case-by-case basis. Switching points could vary, however, as a function of variables relating to the type of case, size of the case, complexity of the case, and amount of the award sought.

50. Substantial numbers of lawsuits fall in this category. For instance, in class action suits the defendant often only requests information about the representative nature of the class, while the plaintiff engages in extensive discovery requests aimed at uncovering facts to support the legal claim.

The two-part cost-shifting rule promotes efficiency and fairness as defined in this article. For the purposes of this article, efficiency concerns the material interests of the two parties in the immediate dispute. Marginal cost-shifting—the first part of the two-part rule—serves the material interests of the parties in the dispute by curtailing abusive discovery requests and thus ensuring greater efficiency. This analysis excludes broader conceptions of social efficiency that could require further curtailment of discovery.[51]

The two-part cost-shifting rule also promotes fairness. A fair trial, narrowly conceived, requires that the court reach its decision by applying the law accurately to the facts of the case. Such a merit-based decision is fair relative to the existing law.[52] Similarly, we describe a settlement of a civil dispute as fair if it equals the expected trial judgment, thereby mimicking the trial outcome. The equalization of discovery costs—the second part of the two-part rule—prevents discovery from distorting the settlement process and promotes settlement on the legal merits of the case.

C. IS A COST-SHIFTING RULE PRACTICAL?

A number of possible objections could be raised against our idealized cost-shifting rule. In this subpart, we address some of the more troubling issues. We believe that many of the practical problems associated with the application of a cost-shifting rule can be overcome, and furthermore, that any costs associated with errors and inaccuracies that arise in applying the rule will be outweighed by the gains in fairness and efficiency.

1. Should Third-Party Discovery Costs Be Shifted?

If a two-part cost-shifting rule can achieve both fairness and efficiency for the requesting and complying parties, what should be done when discovery involves a third party? Suppose, for example, that a plaintiff wishes to depose a number of third-party witnesses at a compliance cost of $1000. Assuming no cost-shifting occurs, the requesting party would bear little or none of the compliance cost. As a result, both parties would engage in excessive third-party discovery requests. Moreover, if cost-shifting applies only to those parties in the litigation, the requesting party will have an incentive to shift some efficient second-party discovery towards inefficient third-party discovery. For example, information relating

51. For example, if a legal dispute merely concerns the redistribution of wealth, and its resolution has no incentive effects on future behavior, then efficiency requires resolving the dispute at least cost. This, in turn, may require prohibiting discovery and replacing trials with administrative judgments.

52. The narrow conception of fairness discussed here depends on the fairness of the underlying law, which may fall short of critical standards of fairness as supplied by conventional morality, ethical theories, or religious traditions. Though we recognize that a settlement based on the "merits" of an unfair law violates critical standards of fairness, we do not attempt to extend our analysis to encompass those standards of fairness.

to market definition in an antitrust case might be obtained from third parties, but could be provided more efficiently by the opposing party in the lawsuit.[53] An incentive for the first party to redirect discovery requests from the second party to the third party exists as long as the law shifts the second party's compliance costs but fails to shift the third-party costs. Therefore, we believe it is appropriate for the requesting party to bear all of the reasonable discovery costs imposed on third parties.

2. Can Moral Hazard and Abusive Responses Be Avoided?

Though our model focuses primarily on abusive discovery requests, we must also consider the implications of the cost-shifting rule on abusive responses to discovery requests. Responding to a discovery request involves interpreting it, gathering the appropriate information, and tailoring and delivering a response. An abusive response results when a party expends an unreasonable amount of time and money answering the question posed by the requesting party. Importantly, a cost-shifting rule increases the incentives for abusive responses by relieving the complying party of some of its obligation to pay for compliance costs.

If the law shifts the costs borne by the complying party to the requesting party, two types of inefficiencies can arise. First, knowing that she will be fully compensated, the complying party will have no incentive to use the cheapest means of collecting and organizing documentary information. Changing her response so as to make it more costly is a form of moral hazard.[54]

The possibility of moral hazard has a further consequence. Assume the requesting party believes that the respondent will waste resources complying with a discovery request, and also assume that the full cost of compliance (including the waste) will be shifted to the requesting party. In these circumstances, the requesting party may be discouraged from discovering essential facts, the requesting party may be encouraged to settle on unfair terms, or the requesting party may even drop the dispute. Under a cost-shifting rule, we use the term "complying party abuse" to refer to the threat of wasteful compliance.

These sources of inefficiency—moral hazard and respondent abuse—could in principle outweigh the benefits of the cost-shifting rule by adding to the total cost of litigation, discouraging parties from making legitimate

53. For a fuller discussion of this point, see Edward H. Cooper, *Discovery Cost Allocation: Comment on Cooter and Rubinfeld*, 23 J. LEGAL STUD. 462, 472 (1994). Cooper notes that amended Civil Rule 45 is now being used by some third parties to protect themselves against having to disclose certain information until the requesting party has agreed to pay the cost of compliance. *Id.*

54. Moral hazard occurs when a party to be insured can affect the probability or magnitude of the event that triggers payment. For example, a party with full medical coverage may visit the doctor more often than a party with limited coverage. *See* ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 604-05 (3d ed. 1995).

discovery requests, and discouraging plaintiffs from bringing some suits with merit. We believe, however, that two extensions of the cost-shifting rule can partially remedy these problems. First, the requesting party could be held responsible only for the *reasonable* costs of responding to the discovery request. Reasonable cost equals the minimum cost of a full response to a particular request. The complying party would be expected to file documentary support for these reasonable costs, and could be sanctioned by the court (or a designated magistrate) for unreasonable costs. While conceptually sound, the "reasonable cost approach" could in itself involve costly satellite litigation if a judge or magistrate must make cost determinations on a request-by-request basis. This approach would be more efficient if reasonable cost determinations could be made case-by-case.[55]

Second, the court could provide a schedule of reimbursements for the typical costs of responding to a discovery request. Such a schedule might spell out the reimbursable costs for various types of interrogatories, depositions, and document requests. Because the cost of responses to discovery requests could vary substantially from case to case, depending on the issues involved and the magnitude of the stakes, the court could be asked to play the role of choosing the appropriate multiple of cost reimbursement to be applied in a particular case. Thus, a cost multiple of 1 might be used for a moderate size case without unusual complexity, 1.5 for a larger case with some complexity, and 2.0 for a very large multidistrict litigation with great complexity. As an example, consider the cost of complying with a document production request in an intellectual property case involving financial accounting and pricing data. If the stakes involved were relatively small and the legal and economic issues straightforward, the court might determine that $10,000 was an appropriate payment for the reasonable cost of compliance. However, if the issues involved were sufficiently complex, substantially greater time and effort might be required to respond to the identical request. Consequently, the court might double or triple its estimate of the reasonable cost of compliance to this production request and to other discovery requests as well.[56]

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55. With respect to the discovery of opposing experts, the Federal Rules of Civil Procedure require cost-shifting of reasonable fees with respect to the payment of expert fees. Rule 26 (b)(4)(C) states:

> (i) the court shall require that the party seeking discovery pay the expert a reasonable fee for time spent in responding to discovery under this subdivision; and (ii) with respect to discovery obtained under subdivision (b)(4)(B) of this rule the court shall require the party seeking discovery to pay the other party a fair portion of the fees and expenses reasonably incurred by the latter party in obtaining facts and opinions from the expert.

FED. R. CIV. P. 26(b)(4)(C).

56. German civil litigation allows for expense reimbursement according to designated schedules. Specifically, the losing party has to pay all of the winning party's necessary

Using a schedule could reduce the transaction costs of shifting discovery costs. More important, a schedule eliminates the incentive for abusive responses, because every dollar *actually* spent responding to a request is borne by the complying party. In other words, the complying party internalizes the marginal cost of responding.

The disadvantage of a schedule is that stipulated costs do not equal the actual reasonable costs of responding to a discovery request in every case. There will be individual cases, therefore, in which the complying party's reimbursements exceed actual costs. This could discourage the first party from making requests. Most important, plaintiffs that have relatively low probabilities of success at trial (or relatively low expected trial awards) may not bring otherwise meritorious suits.[57]

3. Will the Choice of a Particular Switching Rule Reorder Discovery Requests?[58]

Assume the law specifies a particular number of depositions and interrogatories that can be requested before cost-shifting occurs.[59] This particular approach to cost-shifting has a potential problem not found in some other approaches. With any arbitrary switching point, the requesting party has an incentive to reorder the requests so that the complying party bears the burden of the most costly requests. Correspondingly, the complying party has an incentive to front-load the least valuable materials in response to interrogatories, with the hope that this will deter the requesting party from further requests once the shifting point has been reached.

If the requesting party skews its requests towards those that involve the greatest cost first, the complying party could object and be allowed to

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expenses. *See* Act of Civil Procedure, ZPO, para. 91, sec. 1, sentence 1, *in* BGB1.I 533 (1950). With respect to the discovery process, these expenses might include (1) reimbursement of a witness's expenses: the *Gesetz ueber die Entschaedigung von Zeugen und Sachverstaendigen*, (BGB1.I 1756, para. 2); (2) reimbursement of an expert witness's expenses; (3) reimbursement for certain out-of-pocket expenses incurred in providing documentary evidence; (4) lawyers' fees: the fee depends on the value of the claim and on the procedural stages in which the attorney represented the client (preparation of the trial, appearance before the court, discovery, settlement). The exact amounts are provided for in the BRAGO (the federal statute concerning necessary attorneys' fees, published in Bundesgesetzblatt I (1957), p. 907). They do not depend on the time the attorney actually spent working on the case. These fees are considered to be "necessary expenses" and are reimbursed by the losing party; (5) party's expenses: according to paragraph 91 sec. 1 sentence 2 of the ZPO, the winning party can ask the losing party to reimburse expenses for necessary trips and the time spent in court. For the rates, the provision refers to the rates for witnesses as specified in the ZSEG. Other expenses are not reimbursed.

57. With respect to the trade-off between cost schedules and case-by-case determination of costs, see Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65 (1983); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

58. For further discussion, see Cooter & Rubinfeld, *supra* note 1, at 456-57.

59. This problem will be somewhat different if the switching rule depends on the parties' costs rather than the number of discovery requests.

amend the shifting point by reducing the number of requests allowed before cost-shifting becomes effective. Similarly, the requesting party could be allowed to amend the shifting point (extending the number of requests that can be made before shifting occurs) when the complying party has unnecessarily skewed its responses by providing the least useful information first. These suggested solutions are, of course, not without cost; most important, the court would have to make determinations as to the appropriateness of an amendment of the switching point.

4. Will Cost-Shifting Reduce the Number of Suits Filed? Is Such a Reduction Socially Desirable?

A cost-shifting rule will change the mix of suits somewhat. For a suit in which the defendant has more to discover than the plaintiff, cost-shifting will lower the plaintiff's cost of proceeding, thus encouraging the suit. For a suit in which the plaintiff has more to discover than the defendant, cost-shifting will raise the plaintiff's cost of proceeding, thus discouraging the suit. To the extent that plaintiffs tend to make substantially more discovery requests than defendants, the overall effect of a cost-shifting rule could be to reduce the total number of suits. The magnitude of this effect will depend upon the choice of the switching point. If the switching point is set to shift most compliance costs, the mix of cases will change substantially. If the switching point is set to shift only the marginal compliance costs, the mix of cases will change very little.

In any case, the suits discouraged by shifting the cost of compliance with discovery requests will tend to be the ones with the lowest probability of success. Viewed from the perspective of society's goal of deterring socially inappropriate behavior, it is more cost-effective for a relatively small number of high-probability-of-success suits to be brought, rather than a large number of low-probability-of-success suits. A decrease in the number of low-probability filings may be socially desirable. (In general, a cost-shifting rule that discourages low-probability suits can, in combination with other incentives, achieve any desired level of deterrence with reduced litigation costs.)[60] Because some low-probability suits will be meritorious, some low-probability suits that raise broader social issues should either be exempt by statute from the cost-shifting rule, or should be allowed substantial discovery before reaching the shifting point.

60. For an analysis of the effect of cost-shifting on low-probability-of-success suits, see A. Mitchell Polinsky & Daniel L. Rubinfeld, *Optimal Awards and Penalties When the Probability of Winning Varies Among Plaintiffs*, RAND J. ECON. (forthcoming Jan. 1996). The authors show that a system in which losers pay winners can achieve a desired level of deterrence with lower litigation costs than the current American system in which each party bears its own litigation costs.

D. WEALTH CONSTRAINTS AND SOCIAL WELFARE

As a related point, one might object to routine cost-shifting on the grounds that wealth constraints limit the ability of plaintiffs to file and pursue meritorious suits. We believe, however, that the willingness of attorneys to take cases on contingent fees should substantially mitigate this concern. In contingent fee cases, attorneys bear substantial up-front costs of litigation in exchange for a portion of the winning award. This payment arrangement allows plaintiffs with meritorious suits to overcome wealth constraints. Furthermore, contingent fee attorneys can substantially reduce the risk they bear by taking on a large number of cases.

Concerns about wealth can be alleviated further by modifying the proposed cost-shifting rule. Most important, particular areas of law, in which it is deemed socially desirable for plaintiffs to pursue legal claims at relatively low cost, can be excluded from the cost-shifting rule. This exclusion would build on current law that allows for the shifting of legal fees from the losing to the winning party in particular circumstances.[61]

A cost-shifting rule can substantially reduce the incentive for discovery abuse by both the complying and the requesting party by internalizing all of the marginal costs of discovery to the requesting party. Furthermore, a cost-shifting rule can, by equalizing discovery costs, promote fairness in the settlement process. But, can we be certain that cost internalization will be socially optimal? And can we expect that equality in discovery costs will be associated with equality in other legal costs?

Our answer to both questions is, unfortunately, no. To the extent that discovery and litigation generate third-party effects, cost internalization will not necessarily produce socially optimal outcomes. This is neither surprising nor discouraging. Litigation is too complex for a single instrument to provide a satisfactory remedy for third-party effects.

In fact, discovery often creates external effects relating to the provision of information and to deterrence that go beyond the interests of the parties involved in the litigation. To the extent that a cost-shifting rule

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61. For example, the Civil Rights Attorneys' Fees Awards Act, 42 U.S.C. § 1988 (1988), authorized fee-shifting to reduce the burden on plaintiffs wishing to bring suits. Note, however, that in Marek v. Chesny, 473 U.S. 1 (1985), the Court held it appropriate to deny the award of attorneys' fees when the defendant makes a settlement offer that is higher than the award ultimately received at trial. More generally, Rule 68 of the Federal Rules of Civil Procedure allows for partial fee-shifting. If the plaintiff's award at trial is less than defendant's offer of settlement, the plaintiff is responsible for the costs incurred by defendant after the offer was made. FED. R. CIV. P. 68. For a more complete analysis, see Geoffrey P. Miller, *An Economic Analysis of Rule 68*, 15 J. LEGAL STUD. 93 (1986). Note also that Alaska allows for winning plaintiffs to recover attorneys' fees. *See* ALAN J. TOMKINS & THOMAS E. WILLGING, TAXATION OF ATTORNEYS' FEES: PRACTICES IN ENGLISH, ALASKAN, AND FEDERAL COURTS 31-40 (1986). *See generally* Samuel R. Berger, *Court Awarded Attorneys' Fees: What Is "Reasonable?,"* 126 U. PA. L. REV. 281 (1977) (examining when attorney fees can be shifted and developing framework for determining reasonable fee).

discourages discovery, less information may be provided and less deterrence created. If the activities at issue are otherwise overdeterred, the cost-shifting rule would improve social welfare.[62] If there were underdeterrence otherwise, and if litigation were needed to generate sufficient deterrence, then the cost-shifting rule would diminish social welfare.[63]

We believe that these valid concerns should not stand in the way of a reform that introduces cost-shifting. According to the "theory of the second best," if there are two (or more) distortions in the litigation process, correcting one distortion could conceivably reduce social welfare by exacerbating the second.[64] In practice, however, most economic reforms proceed by correcting one distortion at a time. We believe that this strategy works best for law as well as economics. One should therefore not delay discovery reform solely because of a theoretical possibility that failures in other legal institutions will undermine the social benefits. Moreover, other policy instruments can be used to remedy additional inefficiencies in the legal process.[65]

IV. RECENT REFORMS

The general tenor of the recent discovery reforms is that "parties should disclose their own evidence early and often."[66] In this Part, we discuss this move towards mandatory disclosure and suggest why it is unlikely to have much effect on the overall costs of discovery.

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62. One important value of information created by discovery is the increased accuracy of trial and settlement outcomes (in comparison to the outcome that would occur if "complete" information were available). For a further discussion of this point, see Cooter & Rubinfeld, *supra* note 1, at 444-46. *See also* Louis Kaplow, *The Value of Accuracy in Adjudication: An Economic Analysis*, 23 J. LEGAL STUD. 307 (1994) (discussing effect of inaccurate information on implementation of substantive legal norms and on administrative costs).

63. For a more detailed analysis of the scope of discovery as seen from a social perspective, see Bruce L. Hay, *Civil Discovery: Its Effects and Optimal Scope*, 23 J. LEGAL STUD. 481 (1994). For further discussion of the deterrent effect of discovery, see Easterbrook, *supra* note 2, at 636-47.

64. *See* R.G. Lipsey & R.K. Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11 (1956-57).

65. For example, abusive discovery can arise in suits that are deemed frivolous and suits that are deemed to be meritorious. If one believes that frivolous suits are a problem, a separate policy instrument should be applied (e.g., Rule 11 sanctions) rather than a cost-shifting rule. In fact, one of us has elsewhere proposed a number of modifications in the sanctions available for discouraging frivolous legal filings which could help to remedy this problem. *See* A. Mitchell Polinsky & Daniel L. Rubinfeld, *Sanctioning Frivolous Suits: An Economic Analysis*, 82 GEO. L.J. 397 (1993).

66. FED. R. CIV. P. 25.1 (Reporter's Note) (Proposed Draft, Feb. 24, 1990), *quoted in* Linda S. Mullenix, *Hope Over Experience: Mandatory Informal Discovery and the Politics of Rulemaking*, 69 N.C. L. REV. 795, 798 (1991). According to the Rules Advisory Committee, "A major purpose of the revision is to accelerate the exchange of basic information about the case and to eliminate the paper work involved in requesting such information . . . ." *Proposed Amendments to the Federal Rules of Civil Procedure and Forms, Advisory Committee Notes*, 146 F.R.D. 535, 628 (1992).

A. MANDATORY DISCLOSURE

Under mandatory disclosure, the parties must disclose certain information to other parties relatively quickly after the initiation of a suit.[67] General information must be provided within ten days after the mandatory discovery conference.[68] Disclosure of information about experts must be provided at the direction of the court or at least ninety days before trial (or thirty days for rebuttal experts).[69] Finally, pretrial disclosure rules require each party to disclose evidence that it may use at trial other than solely for impeachment purposes.[70]

Because failure to disclose properly may preclude witnesses and their testimony at trial, parties have a strong incentive to satisfy the mandatory disclosure rules.[71] The advocates of mandatory disclosure hope that information will be transferred more quickly and inexpensively. However, in part because mandatory disclosure does not supplant existing discovery procedures, the reform will likely have little or no effect in the majority of cases.[72]

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67. The mandatory disclosure provisions were inspired in part by Judge William Schwarzer of the Federal Judicial Center. *See* William W. Schwarzer, *The Federal Rules, the Adversary Process, and Discovery Reform*, 50 U. PITT. L. REV. 703, 721-23 (1989). For an early overview and commentary, see Ralph K. Winter, *Foreword: In Defense of Discovery Reform*, 58 BROOK. L. REV. 263 (1992). Recent critiques of mandatory disclosure include: Griffin B. Bell et al., *Automatic Disclosure in Discovery—The Rush to Reform*, 27 GA. L. REV. 1 (1992) (arguing that mandatory disclosure will increase confusion in pretrial process, contribute to costs and delay, result in overproduction of documents, and create difficult ethical problems for attorneys); Samuel Issacharoff & George Loewenstein, *Unintended Consequences of Mandatory Disclosure*, 73 TEX. L. REV. 753 (1995) (concluding that mandatory disclosure will increase systematic costs associated with litigation, give greater vitality to "strike" suits, and fail to promote settlement); Carl Tobias, *In Defense of Experimentation with Automatic Disclosure*, 27 GA. L. REV. 665, 667-68 (1993) (claiming that mandatory disclosure should be focus of greater local experimentation before being adopted in federal courts). Judge Schwarzer responds to the Bell critique in William W. Schwarzer, *In Defense of Automatic Disclosure in Discovery*, 27 GA. L. REV. 655 (1993).

68. Rule 26(a)(1) applies to the following: (1) the name, address, and telephone number of individuals and the subjects upon which they are likely to have discoverable information; (2) a copy (or description) of all documents, data compilations, and tangible things in the possession, custody or control of the party that are relevant to the disputed facts; and (3) a computation of damages claimed and documents upon which the computation is based. FED. R. CIV. P. 26(a)(1).

69. Rule 26(a)(2) applies to the identity of any person who may be used at trial to present expert testimony, a written report containing a complete statement of all opinions, reasons, data, qualifications, publications, compensation, and cases in which the expert has testified within the past four years. FED. R. CIV. P. 26(a)(2).

70. Rule 26(a)(3) requires that the name of each witness, deposition testimony to be used at trial, and documents and other exhibits for trial, be provided at least 30 days before trial, unless otherwise directed by the court. FED. R. CIV. P. 26(a)(3).

71. Rule 37 provides that a party "without substantial justification [who] fails to disclose information required by Rule 26(a) or 26(e)(1) shall not, unless such failure is harmless, be permitted to use as evidence at a trial . . . any witness or information not so disclosed." FED. R. CIV. P. 37(c)(1). Other sanctions may also be imposed at the discretion of the court. *Id.*

72. According to David M. Trubek et al., *The Costs of Ordinary Litigation*, 31 UCLA L.

In many cases involving discovery, the opposing parties would provide necessary information without mandatory disclosure.[73] The impact of mandatory disclosure in particular cases, however, could be significant. For example, mandatory disclosure will probably affect substantially cases involving relatively low stakes because it will compel the disclosure of information that might have been too costly for the other party to request. In more complex litigation with higher stakes, the parties will likely agree to obtain additional information through the use of traditional discovery devices, such as interrogatories and depositions.

Mandatory disclosure could either increase or decrease the amount of information provided during the litigation process, depending on the particularities of the case and the parties involved. By moving the provision of information forward in time, mandatory disclosure could conceivably lead to earlier settlements with lower overall pretrial litigation costs. Moreover, it is theoretically possible that by encouraging the provision of more information earlier in a case, mandatory disclosure could reduce divergent expectations, encourage settlements, decrease trial costs, and therefore further reduce the aggregate cost of information provision.

It is not clear to us, however, that earlier provision of information will substantially reduce discovery or trial costs; in fact, it is more likely to alter the timing, rather than the extent of settlements.[74] Further, we share the concerns of Justice Scalia and other opponents of automatic disclosure that the new requirement (in conjunction with the use of sanctions) may encourage parties to overcomply with the mandatory disclosure provisions, providing too much information and adding to litigation costs.[75] Overcom-

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REV. 72, 90 (1983), approximately half of all cases filed in federal court settle without any discovery.

73. The incentive to reveal information voluntarily probably diminishes when one or both parties are repeat players. A repeat player might hold back information that could be used adversely in other proceedings. Moreover, in some situations a party may choose to maintain a blank face, particularly if they believe that by revealing some beneficial information, the other party is more likely to believe that adverse information will be available upon discovery.

74. Costs could be increased if trial lawyers are tempted to hire nontrial lawyers to handle pretrial discovery, and to hire nontestifying experts to undertake preliminary work in a case. Further, mandatory disclosure could encourage attorneys to avoid putting certain things in writing. *See* Anne Y. Shields, *The Utility of Disclosure as a Reform to the Pretrial Discovery Process*, 67 ST. JOHN'S L. REV. 907, 916-17 (1993) (arguing that general disclosure system increases expense of discovery, does little to curtail problem of overdiscovery, and fails to focus litigation effectively).

75. COMMUNICATION FROM THE CHIEF JUSTICE OF THE UNITED STATES, AMENDMENTS TO THE FEDERAL RULES OF CIVIL PROCEDURE AND FORMS, H.R. DOC. NO. 74, 103d Cong., 1st Sess. 107-09 (1993) (Scalia, J., dissenting); *see also* Bell et al., *supra* note 67, at 1 (arguing that mandatory disclosure will increase confusion in pretrial process, contribute to added costs and delay, result in overproduction of documents, and present difficult ethical problems to attorneys).

pliance can be a useful tactical tool—it increases the other party's costs of finding and evaluating useful information. More specifically, rational parties in the litigation process will likely overcomply when facing an uncertain legal standard of disclosure. Overcompliance provides a margin of error in case the complying party is threatened with legal action for allegedly not complying with the mandatory discovery rules. (In general, vague liability standards tend to induce overcompliance.)[76]

To the extent that settlement rates are affected, we believe it is more likely that mandatory disclosure will lead to fewer settlements, with the possibility of higher litigation costs. In general terms, the likelihood of settlement is greater when the parties have similar expectations about trial outcomes, and they can gain a large joint surplus by avoiding further settlement costs and trial costs.[77] When the parties' expectations differ, settlements occur more frequently when the plaintiff is relatively pessimistic about the trial outcome compared to the defendant. Conversely, disputes tend to go to trial when the plaintiff is sufficiently optimistic (in comparison to the defendant) about the expected trial outcome; under those circumstances, the difference in expected outcomes outweighs the potential savings in expected settlement and trial costs. We believe that mandatory disclosure will diminish the frequency of settlements by increasing the relative optimism of the parties.

A two-stage model of settlement bargaining demonstrates the reasoning behind that conclusion. Assume for simplicity that settlement negotiations prior to trial occur only twice in the litigation process—once after the suit is filed, but prior to discovery, and a second time, after discovery is complete on the eve of trial. A decision at the first stage not to settle, and consequently to pursue discovery, results when the parties fail to reach an agreement that they perceive makes them better off. A similar analysis applies to the decision to go to trial at the second stage.

Our evaluation concentrates on (a) the effect of the mandatory disclosure on the expectations of the parties, and (b) the effect of mandatory disclosure on the settlement surplus at each of the two stages of settlement

76. *See, e.g.*, John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965 (1984) (concluding that potential defendants faced with uncertain legal standard will modify their behavior beyond point that would be socially optimal because they can experience private gain). These costs would be compounded if satellite litigation arose to evaluate whether the opposing party had properly complied with the mandatory disclosure requirements.

77. At the initial prediscovery settlement negotiations, the joint surplus consists of all additional settlement costs and trial costs that would be forgone by both parties if an initial settlement was reached. At the second pretrial negotiation, only the trial costs come into play because all discovery costs have been sunk. For a recent review of the literature on settlements, see Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LITERATURE 1067 (1989).

bargaining.[78]

Mandatory disclosure could have several potentially important effects. First, mandatory disclosure can affect initial settlements. To the extent that the transmitted information moves the parties' positions closer, expectations would tend to converge, thereby reducing the relative optimism of the plaintiff. This, in turn, would increase the likelihood of settlement. Of course, an increased probability of settlement, other things the same, would reduce the total costs of litigation. We believe, however, it is more likely that mandatory disclosure will impede rather than encourage initial settlements by forcing parties to disclose information that causes expectations to diverge.

To see why, we need first to analyze the effects of voluntary disclosure. Any increase in the defendant's expectations about a trial judgment for the plaintiff causes an increase in the settlement value to the plaintiff. Consequently, the plaintiff who anticipates a settlement will voluntarily disclose any information that causes the defendant to expect a higher judgment for the plaintiff.[79] When the defendant expects a higher judgment at trial, he is likely to make a more generous settlement offer, which makes settlement more likely. Similarly, the defendant who anticipates a settlement will voluntarily disclose any information that causes the plaintiff to expect a lower trial judgment. When the plaintiff expects a lower judgment at trial, he is likely to demand less to settle out of court, which makes settlement more likely. Through this process of self-interested, voluntary disclosure, the parties provide each other with valuable information that promotes settlements.

We explained why voluntary disclosure promotes settlements. In so far as mandatory disclosure merely compels the parties to disclose what they would have revealed voluntarily, mandatory disclosure contributes no new information to settlement bargaining. In addition, the administrative costs of mandatory disclosure probably exceed the administrative costs of voluntary disclosure of the same information. Given these facts, the justification of mandatory disclosure cannot rest on information that would have been disclosed voluntarily. Instead, the justification of mandatory disclosure must rest on information that the parties would not reveal voluntarily prior to trial.

As we have suggested previously, involuntary disclosure may reduce the

78. Issacharoff and Loewenstein present a somewhat different perspective on the effect of mandatory disclosure on settlement, focusing on psychological as well as economic models of litigant behavior. *See* Issacharoff & Loewenstein, *supra* note 67.

79. There are some situations, of course, in which a party will choose not to reveal some information prior to trial. Steven Shavell, *Sharing of Information Prior to Settlement or Litigation*, 20 RAND J. ECON. 183 (1989), suggests two reasons: (1) it may be difficult for a plaintiff to convince a defendant that private information is valid; and (2) the surprise revelation of private information at trial may be more valuable than revelation during the normal course of discovery.

ability of the parties to settle. The demonstration of this fact is the converse of the demonstration concerning voluntary disclosure. The plaintiff will want to withhold any information from the defendant that causes him to expect a lower judgment for the plaintiff at trial. Mandatory discovery will make the plaintiff involuntarily disclose some of these facts. When the defendant expects a lower judgment at trial, he is likely to make a less generous settlement offer, which makes settlement more difficult. Similarly, the defendant will want to withhold any information from the plaintiff that causes him to expect a higher judgment at trial. Mandatory discovery will make the defendant involuntarily disclose some of these facts. When the plaintiff expects a higher judgment at trial, he is likely to demand more to settle, which makes settlement more difficult. Thus, mandatory discovery causes involuntary disclosure of information that tends to undermine settlements.[80]

This generalization captures what appears to us as the primary incentive effects of mandatory disclosure. We recognize, however, that effects which we consider to be secondary could go in the opposite direction. For example, mandatory disclosure may be less susceptible to strategic manipulation, because discovery rules determine what is disclosed. Avoidance of strategic manipulation may itself tend to avoid divergent expectations, and therefore increase the probability of settlement. Only empirical research can determine whether the primary incentive effects will dominate as we predict, or whether secondary effects will prove more powerful.

We have discussed how mandatory discovery causes the disclosure of information that discourages settlements. A similar result is produced by shifting the timing of information costs. If mandatory disclosure increases information available before the trial, both parties may expect reduced trial costs. As a result, the benefit of settling at the pretrial negotiation stage shrinks. Shrinking the surplus from settling should lead to more trials.

Shifting the timing of disclosure also affects the total cost of exchanging information. Two considerations work in opposite directions with respect to the timing of disclosure. Discovery is less formal than trials. Consequently, discovering information before trial is usually cheaper than obtaining the same information at trial. This fact tends to cause mandatory discovery to lower the total information costs of resolving a dispute. Unfortunately, another fact works in the opposite direction. If an inquiry is postponed until trial, a settlement out of court will preclude the necessity of ever obtaining the information. Thus, shifting the timing of disclosure from discovery to trial increases the probability of escaping some information costs.

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80. In contrast, Linda Mullenix argues against the recent reforms on the grounds that discovery abuse is not so common as is often alleged. *See* Linda Mullenix, *Discovery in Disarray: The Pervasive Myth of Discovery Abuse and the Consequences for Unfounded Rulemaking*, 46 STAN. L. REV. 1393-445 (1994).

Finally, mandatory disclosure could significantly increase the incentives for plaintiffs to bring suits. Mandatory disclosure typically imposes greater demands on the parties to reveal information early in the litigation process. To the extent that the majority of disclosure is made by defendants at their own expense, and to the extent that the disclosure involves more than bare-bones responses (e.g., detailed information about the expert's opinions), the plaintiff faces a reduced cost of proceeding with a suit sufficiently far to obtain an accurate assessment of the suit's prospects.

Just as the current discovery rules encourage discovery abuse by lowering the relative cost of obtaining information for the plaintiff, mandatory disclosure could encourage the filing of suits with relatively low probabilities of success and/or relatively low potential benefits to the plaintiff. Because these frivolous filings sometimes come from plaintiffs hoping to extract a settlement, the reform could create inefficiencies.[81] However, the contrary could also be true. Mandatory disclosure could encourage some suits that generate benefits which are enjoyed by parties other than the plaintiff and are socially desirable.[82] Thus, a definitive conclusion about the effects of mandatory disclosure on social welfare would require further investigation and analysis.

B. OTHER RECENT REFORMS

Beyond mandatory disclosure, the new Federal Rules of Civil Procedure add two factors for the judge to consider when deciding whether to impose limits upon discovery. When evaluating whether the burden or expense of the proposed discovery *outweighs its likely benefit*, the judge may now take into account (a) the parties' resources and (b) the importance of the proposed discovery in resolving the issues.[83]

According to Ralph Winter, this change was designed to "address ... the problem of waste as a result of a no-stone-left-unturned philosophy and the problem of costly discovery being used against the other party."[84] Winter notes, however, that the amendment's "impact is uncertain."[85] The change will have no effect when all parties agree to excessive discovery or when district judges or magistrates do not enforce the agreement. Moreover, Winter notes that judges have difficulty making a cost-benefit judgment to determine whether the discovery is important for resolving disputed

81. *See, e.g.*, Lucian A. Bebchuk, *Suing Solely To Extract a Settlement Offer*, 17 J. LEGAL STUD. 437 (1988) (arguing that some frivolous suits are brought because asymmetries of information enable parties to extract settlement offers).

82. *See* Steven Shavell, *The Social Versus the Private Incentive to Bring Suit in a Costly Legal System*, 11 J. LEGAL STUD. 333 (1982) (concluding that lawsuits may produce positive externality that benefits society).

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

84. Winter, *supra* note 67, at 265.

85. *Id.*

issues, or to avoid the judicial tendency to permit discovery. If judges do take on the responsibility of policing discovery, a proper cost-benefit analysis would require them to become involved in the particulars of the discovery process.

We believe that such involvement could be constructive if the courts are given a set of guidelines for making cost-benefit balancing decisions. We hope the framework discussed in this article can help to make that possible.[86] However, as we have explained, practical problems abound even within a cost-benefit framework.[87]

We believe therefore, that a move to a partial cost-shifting rule represents a more constructive approach to discovery reform. Appropriately designed, this cost-shifting rule would give the requesting parties (both defendant and plaintiff) the incentive to engage in the correct cost-benefit analysis, thus promoting the spirit of the recent reforms.

V. CONCLUSION

Reform of discovery rules should aim to internalize and allocate discovery costs fairly. Internalizing discovery costs eliminates abuse and promotes efficiency. Equalizing discovery costs eliminates distortions in bargaining power and promotes fairness. We have suggested that a two-part cost-shifting rule can achieve both objectives while reducing the administrative burden faced by judges. While we recognize that a number of practical difficulties exist, we believe that cost-shifting can be effective. To borrow from Winston Churchill's insightful comment about democracy, "Cost-shifting is the worst rule, except for all the other alternatives."

86. It is unclear to what extent these factors will actually alter the balancing test that judges conducted under the old standard. For example, in an unpublished district court opinion for a sex discrimination case, the judge found that the burden imposed by interviewing 160 additional women beyond the 90 who had been pregnant exceeded the "likely benefit." EEOC v. Sundstrand Corp., No. 92-C20287, 1994 U.S. Dist. LEXIS 8248, at *4 (N.D. Ill. June 15, 1994). Yet, the footnote indicated that the judge would have arrived at the same conclusion under the "unreasonably cumulative or duplicative" standard found in both the old and new rules. *Id.* at *4 n.1.

87. A number of these issues have been addressed in a thoughtful commentary. *See* Cooper, *supra* note 53 (identifying wide variety of practical and theoretical difficulties that must be addressed to implement effectively cost-shifting scheme).