SHIFTING PLAINTIFFS'
FEES VERSUS INCREASING
DAMAGE AWARDS

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ABSTRACT

Shifting successful plaintiffs' fees to defendants and increasing damage awards are alternative ways to achieve similar results: increasing plaintiffs' incentives to sue and raising defendants' expected payments. This paper shows that relying on higher damage awards is more efficient than shifting plaintiffs' fees. The reason is that fee-shifting is, perversely, more valuable for plaintiffs with higher litigation costs. Thus, it is possible to substitute higher damage awards for fee-shifting in a manner that leaves deterrence unaffected while eliminating the suits of plaintiffs with the highest litigation costs.

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1. Introduction

Many statutes and proposals involve shifting victorious plaintiffs' fees or other costs to defendants in order to encourage the filing of lawsuits and increase liable defendants' expected payments. Increasing damage awards, as by using a multiplier, is an alternative, less frequently employed technique of accomplishing these results. This paper demonstrates that using higher damage awards rather than shifting plaintiffs' fees enables one to produce the same expected penalty for defendants while reducing total litigation costs.

Section 2 proves the result in the context of a simple model of litigation. The intuition is that increasing damages rewards plaintiffs in a manner that depends upon their probability of victory, without regard to their litigation costs. In contrast, fee-shifting is relatively more valuable to plaintiffs whose litigation costs are higher. As a result, substituting higher damage awards for fee-shifting reduces the number of suits by eliminating those suits that involve the highest litigation costs. The total costs of litigation are thereby reduced. Deterrence is maintained because, with higher damage awards, defendants pay more when losing to plaintiffs who have low litigation costs than they paid with fee-shifting.[1]

This result is in the spirit of Becker's (1968) argument with respect to public law enforcement that it saves resources to achieve a given level of

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[1] To illustrate, suppose that plaintiffs have a .5 probability of winning 100, and that all of victorious plaintiffs' fees are shifted to defendants. Then, all prospective plaintiffs with costs less than or equal to 100 would sue. (If a plaintiff's cost is 100, a loss costs 100 and a victory produces a net gain of 100 -- a total recovery of 200 minus the 100 in litigation costs -- and there is an equal chance of each outcome, so the plaintiff would be just indifferent as to whether to sue.) If, instead, damages were increased to 150, and fee-shifting were eliminated, then plaintiffs would only sue if their costs did not exceed 75. (There is a .5 chance of losing, which costs 75, and a .5 chance of winning 150 - 75 = 75.) Observe that defendants would pay more when they lose to low-cost plaintiffs than they did previously. (If the plaintiff's cost was less than 50, with fee-shifting the total payment contingent on losing was less than 150, but now it equals 150.) So long as there are enough low-cost plaintiffs, defendants' expected payments will remain the same, so deterrence will be achieved at lower cost. (For any reduction in the extent to which plaintiffs' fees are shifted, one can maintain deterrence simply by raising damage awards enough. The proof in section 2 demonstrates that this increase in damage awards will be less than the reduction in shifting of fees for the highest-cost plaintiffs who previously sued, so they will no longer sue.)

deterrence with a lower probability and a higher sanction. The result here involves fewer plaintiffs bringing suit, while those who sue and are successful recover more, on average. In this setting, however, the result arises in a rather different manner, and the reduction in private suits involves the more costly ones.

Section 3 offers extensions concerning two-way fee-shifting, the possibility of settlement, endogeneity of litigation costs, risk aversion, suits for nonmonetary relief, and the case in which plaintiffs differ not only in their litigation costs but also in their probability of success. Section 4 concludes by discussing the choice among methods of encouraging and discouraging suits. This section addresses the relationship between this article and recent literature on penalizing losing plaintiffs and decoupling defendants' payments and plaintiffs' awards.

2. Model and Analysis

Risk-neutral parties engage in litigation. Plaintiffs have a probability of victory of p. Possible plaintiffs differ in their litigation costs c, where c has the distribution $f(c)$.[2] The damages awarded are d, subject to a multiplier m. The defendant pays the share s of a victorious plaintiff's costs. Finally, a defendant incurs litigation costs of k.

Thus, a plaintiff will sue if and only if

(1) pmd - c(1 - ps) ≥ 0.

In expression (1), pmd represents the expected judgment at trial, c is the plaintiff's litigation cost, while a plaintiff's expected recovery of costs is psc. From (1), it follows that a plaintiff will sue if and only if his litigation costs are below a threshold,

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[2] Litigation costs are treated as a unit, not distinguishing between fees and other costs, a distinction made in some fee- or cost-shifting rules.

(2) $c* = \dfrac{pmd}{1 - ps}$.

A defendant's behavior is assumed to be determined by the expected total
costs as a result of the prospect of litigation. This aggregate expected cost
is

(3) $E = \displaystyle\int_{0}^{c*} (pmd + psc + k)f(c)dc$.

The integrand is the defendant's expected cost from a plaintiff of type c who
sues, weighted by the portion of plaintiffs who will be of that type. The
expected award is pmd, the expected fee-shifting cost is psc, and the
defendant's direct cost is k. Only plaintiffs with costs less than or equal
to c* sue, which explains the upper limit of integration.[3]

The social objective is taken to be the minimization of expected
litigation costs, subject to the constraint that the defendant's behavior is
unaffected -- i.e., that E in (3) is constant. Expected social costs are

(4) $L = \displaystyle\int_{0}^{c*} (c + k)f(c)dc$.

For any suit that takes place, the total costs will be c for the plaintiff
(the amount will depend on the plaintiff's type) and k for the defendant.

To prove the main result, consider the experiment of raising m and
reducing s such that c* remains constant. That is, for a given increase in
the damage award, reduce the extent of fee-shifting in just the amount
necessary to leave potential plaintiffs' decisions whether to sue unaffected.
This involves determining s as a function of m, so that the derivative of c*
in (2) equals zero. Taking this derivative yields

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[3] This problem can be interpreted in two ways. One is that a defendant
injures a single individual. The distribution $f(\cdot)$ represents the probability
that the person who is injured will have litigation costs of c.
Alternatively, the defendant may injure many individuals, and $f(\cdot)$ would give
the distribution of characteristics of those individuals.

(5) $\dfrac{ds}{dm} = -\dfrac{1 - ps}{pm}$.

Consider now expression (3), for E. The upper limit of integration, by construction, does not change as m is increased and s reduced according to (5). Thus, the only effect on the value of E would be through the first component of the integrand:

(6) $\dfrac{d}{dm}\big|_{s=s(m)}(pmd + psc + k) = pd + pc\dfrac{ds}{dm}$

$= pd - \dfrac{pc(1 - ps)}{pm}$

$= \dfrac{1}{m}(pmd - c(1 - ps)) \geq 0$.

The final inequality follows from (1), the condition for the plaintiff to sue. Moreover, except when evaluated at c^*, the inequality will be strict. Thus, the integrand rises while the limits of integration remain the same; hence, E rises.

Therefore, given an increase in m, the decrease in s necessary to keep E constant -- and thus the defendant's incentives the same -- is greater than that given by (5). In other words, s must fall by more than the amount necessary to keep c^* constant.[4] This fall in s will, therefore, reduce c^*.

Consider, now, how this increase in m and reduction in s that keeps E constant will affect social cost (4). The integrand is unaffected, but, as just noted, c^* falls. Therefore, the social cost L falls. Observe that this arises because fewer individuals sue (or, equivalently, the probability of a suit is lower). In particular, those plaintiffs who no longer find it profitable to sue are those with costs near the former, higher level of c^* -- the highest-cost plaintiffs.

This demonstrates that the optimal value of s -- the optimal extent to which the plaintiff's fees are shifted -- is as low as possible. Note that negative shifting would, in principle, be optimal. It would involve taxing

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[4] It is straightforward that s must fall by more than the amount given by (4) rather than less. When s falls, c^* and the integrand in (2) fall, both causing E to fall.

the victorious plaintiff's fees, with the tax paid to the defendant. Such a rule, combined with a higher damage award, would increase the extent to which higher-cost plaintiffs were deterred from suing. In the limit, one could achieve a desired level of deterrence with a minuscule probability of suit and an extremely high damage award, just as in the result due to Becker (1968) that optimal enforcement involves high sanctions applied with a low probability.[5]

3. Extensions

(a) *Two-way fee-shifting*. The model could be extended to incorporate shifting a portion of the successful defendant's fees as well. If one takes the extent of shifting of the defendant's fees as given, the results are precisely as given in section 2. That is, when a two-way fee-shifting rule is employed, it would reduce costs to reduce the plaintiff fee component. Thus, it is efficient to replace two-way fee shifting with shifting of only the defendant's fees, while increasing the damage award to leave the defendant's expected payments the same.

(b) *Settlement*. It is clear that with simple models of settlement, the results would be qualitatively the same. Increasing the damage award and reducing the extent of fee-shifting in a manner that keeps the defendant's expected payment the same will be relatively disadvantageous to plaintiffs with higher costs, long as the amount of a settlement is positively related to trial awards.[6] The importance of any result is reduced to the extent most cases will settle and settlements are less costly. Only if all cases settle and settlement is costless, however, would the benefits described herein vanish entirely.

Shifting plaintiffs' fees and increasing damage awards may have different effects on the probability of settlement. Substituting a higher damage award

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[5] The usual caveats, such as risk aversion (discussed in section 3) and limits on parties' wealth, apply.

[6] Determining how much one must reduce fee-shifting for a given increase in the damage award to keep a defendant's expected payments unaffected will, of course, depend on the model of settlement, and will usually be complicated.

for fee-shifting can be shown to increase recoveries of successful plaintiffs.[7] A defendant's expected payment at trial correspondingly increases. But, if parties are relatively over-optimistic (i.e., if the plaintiff's estimate of the probability of victory exceeds the defendant's estimate), the plaintiff's minimally acceptable demand rises by more than the defendant's maximum offer rises, which makes settlement less likely.[8] Thus, costs may rise for the fewer number of cases that continue to be brought.[9]

(c) *Endogenous litigation costs*. Litigation costs were taken as given. But damage awards and fee-shifting affect litigation costs. First, as just noted, substituting a higher damage award for fee-shifting increases recoveries of successful plaintiffs. This increase in stakes would tend to increase litigation expenditures per case. Second, reducing fee-shifting raises the expected marginal cost to the plaintiff of litigation expenditures. This would tend to decrease litigation expenditures per case.[10] Both effects, of course, would apply only to the smaller population who continue to sue (and these effects would in turn affect the incentive to sue).

(d) *Risk aversion*. The analysis assumed that the parties were risk-neutral. Moving from shifting plaintiffs' fees to higher damage awards has the effect of increasing successful plaintiffs' recoveries, while fewer prospective plaintiffs sue. This, of course, introduces more risk for both plaintiffs and defendants,[11] which would be relevant to the extent parties are risk-averse and not fully insured.

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[7] Since suit is less likely and the defendant's expected payment is the same, it must be that those who sue have higher expected recoveries. Changing the damage award and fee-shifting rule is irrelevant for plaintiffs who ultimately lose. Thus, it must be that those who win recover more.

[8] This is necessarily true only in a simple model in which there is settlement if and only if a mutually beneficial settlement exists.

[9] It is not obvious that such a possibility should, in principle, weigh against a change. To illustrate, a technology that cut litigation costs in half would make settlement less likely. Should such a technology be viewed as undesirable on that account? One could always use the technology and tax litigation expenditures (e.g., tax lawyers' fees) in a manner that kept private costs and thus settlements unaffected while reducing the resource costs of litigation. A similar tax on litigation expenditures here or in other contexts would increase settlements without increasing real resources devoted to lawsuits.

[10] Katz (1987) analyzes effects of both types.

(e) *Suits for nonmonetary relief*. In some contexts, such as certain
civil rights or environmental suits where shifting of plaintiffs' fees has
been prominent, it might be the case that a plaintiffs' remedy is nonmonetary,
in which case increasing damage awards appears to be infeasible. But one
could always substitute a direct award of money for shifting of the
plaintiff's fees. In particular, consider a monetary award equal to a typical
plaintiff's legal costs, rather than the actual plaintiff's. Such awards
would be relatively more attractive to plaintiffs with lower costs. Moreover,
one might save the costs of litigating about what the plaintiffs' costs
actually were.[12]

(f) *Plaintiffs with differing litigation costs and probabilities of
success*. One could extend the model to allow plaintiffs to differ in two
dimensions: litigation costs and the probability of success.[13] The analysis
would be more complex because raising damage awards and reducing fee-shifting
would have differing effects on plaintiffs with different probabilities of
success. In particular, a change that kept deterrence unaffected would
eliminate some of the highest-cost suits (which would have had high costs and
high probabilities of success) but encourage some lower-cost suits (which
would have low costs and low probabilities of success). As a result, while
the typical suit would be a less costly one, the analysis would have to
account for the possibility that the number of suits would increase.[14] This
problem would be less important if classes of cases have similar probabilities

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[11] Plaintiffs who sue have a wider range of possible recoveries. For
defendants, suit is less likely, but the cost of losing is greater.

[12] Such litigation usually involves inquiries into the amount of work effort,
whether the work effort was appropriate, how the effort should be valued, and
what if any multiplier should be applied to account for risk. The latter
inquiry is problematic, as it might appear to reward more heavily less
meritorious cases. (For example, a case with a one percent ex ante
probability of success might be seen as entitled to a fee multiplier of one
hundred; this would hardly serve to help select cases with high probabilities
and low costs.) The proposed alternative would, however, require a
determination of the appropriate level of the monetary award, although it may
be possible to do this once for each type of case.

[13] Formally, one would have $f(c,p)$ be the joint distribution of c and p.

[14] Because the low-cost suits that replace the high-cost suits have a lower
probability of success, they may provide less deterrence, so it is possible
that more suits would be required, even though they would be cheaper suits.

of success (so that damage awards could be tailored to particular cases) or if one could separately discourage low probability suits (as discussed in section 4).

4. Choosing Among Methods of Encouraging and Discouraging Suits

Suits can be encouraged by raising damage awards, shifting victorious plaintiffs' fees to defendants, or subsidizing the filing of suits (e.g., by providing free legal services). Similarly, suits can be discouraged by reducing damage awards, shifting victorious defendants' fees to plaintiffs, imposing other penalties on losing plaintiffs, or by charging filing fees.[15] This paper has shown that shifting victorious plaintiffs' fees to defendants rather than raising damage awards may be a perverse way to encourage suits, since the inducement tends to be more attractive to higher-cost plaintiffs. Similar deterrence may be achieved, but with more suits and, in particular, by encouraging suits that are relatively more expensive.

Recent literature has explored other ways of adjusting the rewards and penalties for bringing suit that would reduce litigation costs. Polinsky and Rubinfeld (1992a, 1992b) indicate that penalizing losing plaintiffs, while increasing the award for those who win, can reduce the number of suits necessary to achieve a given level of deterrence.[16] (In particular, this change makes suit less attractive to plaintiffs with low probabilities of success -- less "meritorious" cases -- while increasing the net expected award to those with high probabilities.[17]) Polinsky and Che (1991) demonstrate how decoupling -- making the defendant pay damages that differ from what a plaintiff receives -- can achieve a given level of deterrence with fewer

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[15] Obviously, many other changes in legal rules would affect the incentive to file suits.

[16] Katz (1990) discusses penalizing losing plaintiffs, but does not consider increasing awards to those who win.

[17] Polinsky and Rubinfeld's papers (1992a, 1992b) are close in spirit to the present article. They focus on discouraging low-probability plaintiffs, while this article focuses on discouraging high-cost plaintiffs. (Another difference is that the model here allows for a continuum of plaintiffs, making the benefit of an extreme solution, discussed at the end of section 2, more apparent.)

suits. (For example, increasing the defendant's payment and decreasing prospective plaintiffs' recoveries induces fewer to sue, but maintains deterrence by making the defendant pay more in each successful suit.)

This literature and the present article offer some basis for choosing among the ways of affecting the incentive to sue.[18] Filing subsidies increase deterrence by encouraging suits, without particular regard for litigation costs or the merits. Shifting plaintiffs' fees to defendants has a relatively greater effect for meritorious cases, but this method of increasing deterrence also increases litigation, with the additional suits being filed by plaintiffs with higher legal costs. In contrast, increasing damage awards for victorious plaintiffs (or penalizing losing plaintiffs, directly or by shifting defendants' fees) targets plaintiffs solely according to their probability of success. Decoupling allows one to discourage more costly and lower probability suits. These latter alternatives, therefore, allow a given level of deterrence to be achieved with fewer, less costly suits.[19]

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[18] The discussion here is limited to policies that directly affect the decision whether to sue, rather than those concerned with settlement, although both types of policies obviously affect both suit and settlement.

[19] When cases are heterogeneous and cannot be distinguished by adjudicators, common damage multipliers, fee-shifting rules, and the like must be applied. The result is that there will be excessive litigation and deterrence for some acts and inadequate litigation and deterrence for others. It is possible in such a setting that a different mix of rules might be appropriate than otherwise, although it is not obvious which methods of encouraging litigation thus appear more or less attractive.

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