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Legislative Development, The Attorney Accountability Act: A Case Study of the Complexities of Incentive-Based Legal Reform

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The Attorney Accountability Act: A Case Study of the Complexities of Incentive-Based Legal Reform

Jamie S. Henikoff & Scott R. Peppet

The recent "litigation explosion" has not only burdened court dockets, but has also led many to question the ongoing vitality and integrity of our legal system. In an attempt to address these concerns, legislatures have increasingly tried to curb meritless suits by reigning in litigants and their attorneys. One common reform approach is incentive-based; it centers on altering the costs of going to trial. Last year, Congress considered a bill intended to encourage early settlement by requiring litigants to weigh the cost of opposing attorneys' fees in their pre-trial settlement decisions. This comment analyzes the proposed Attorney Accountability Act (the Act) and employs several analytical tools from the negotiation field to highlight some of the drawbacks of such incentive-based approaches to legal reform. In particular, the concepts of strategic interaction, opportunism and risk preferences, and principal-agent dynamics illuminate some of the unforeseen barriers to effecting such legislation.

1. Why Focus on the Attorney Accountability Act?

The Act, if passed, would amend federal civil procedure Rule 68 by creating a two-way offer-of-settlement rule by which parties could seek compensation for certain attorneys' fees. This provision is meant to deter meritless lawsuits by increasing incentives to settle claims early and out of court. The changes provide that if a litigant rejects a settlement offer, proceeds to trial, and ultimately fares worse under the final judgment than she would under the terms of the settlement offer, that litigant must pay the offeror's post-offer costs and attorneys' fees.³

2. See id. at § 2. The Act also contains two related provisions: (1) a revision of Rule 702 of the Federal Rules of Evidence to include an "honesty in evidence" rule, see id. at § 3, and (2) an augmentation of Rule 11 attorney sanctions, see id. at § 4.
3. See id. at § 2(e)(6).
Although the Act did not become law, analysis of this fee-shifting provision is important for several reasons. First, the Act is typical of incentive-based approaches to legal reform. It is meant to create certain consequences by changing the costs and benefits parties incur in litigation. Incentive-based approaches are pervasive; many states already have fee-shifting statutes, and the comparative advantages of various background incentive rules have been the subject of much analysis. Precisely because procedural changes like those in the Act can influence millions of ordinary people seeking access to judicial relief, thorough analysis is important.

Second, a great deal of legal commentary has advocated increasing the severity of Rule 68 by requiring shifts in attorneys' fees in addition to mere court costs. Scholars have argued that Rule 68's current focus on court costs limits its effectiveness as a deterrent and that increasing the burdens borne by intransigent litigants will only further the Rule's underlying purpose of encouraging early and efficient settlement. Although the discussion in this comment focuses solely on the Attorney Accountability Act, the concepts employed are generalizable to future attempts at and debate over incentive-based legal reform.

II. THE ATTORNEY ACCOUNTABILITY ACT: FORESEEN EFFECTS

A. Provisions

Section Two of the Act provides a framework under which the proposed offer-of-settlement fee-shifting mechanism would operate. The Act's fee-shifting mandate is only triggered in cases involving federal diversity litigation, where the court possesses existing jurisdiction over the underlying action, and when the relevant offer was made at least ten days prior to trial. Specifically, if a party receives

4. The Act was referred to Senate Committee on March 15, 1995. See 141 Cong. Rec. S3963 (daily ed. Mar. 15, 1995). No action has been taken on it since.
8. See H.R. 988, supra note 1, at § 2.
9. See id. at § 2(e)(1).
an ultimate judgment at trial that is less favorable than an offer that she rejected prior to trial, then that party must bear the other side's costs, expenses, and reasonable attorneys' fees from either the date upon which the rejected offer was filed, or the last date upon which she made a counter-offer. The Act allows parties to make as many offers as they wish, with the understanding that none of the rejected offers may be used as evidence in trial. In addition, the Act grants courts the discretion, with or without a party's motion, to exempt from the proposed fee-shifting rule any claims that present novel questions of law or fact or that may substantially impact non-parties. Finally, the rule is not to be applied to claims seeking equitable remedies.

The Act moderates the impact of the fee-shifting requirement in two principle ways. First, courts are given the discretion not to award fees if to do so would be “manifestly unjust.” Second, the Act limits recovery to those fees that are deemed “reasonable” based on attorney qualifications, comparable hourly rates, number of hours worked, etc. The Act also specifically states that shifted fees may not exceed either the offeree's actual attorneys' fees or — if the offeree is operating under a contingency fee arrangement — the estimated costs that the offeree would have incurred under a non-contingency fee arrangement.

B. Perceived Benefits

Although the House of Representatives passed the Act very quickly, and thus left scant legislative record, the Act's various goals can be gleaned from the congressional debate. First and foremost, the Act was intended to reduce the burden on federal courts and increase efficiency in the federal judicial process. It was hoped that the fee-shifting proposal would encourage early settlement, and

10. See id. at § 2(e)(6).
11. The only exception to this rule is that parties can use rejected offers as evidence to enforce a settlement or to determine costs under the Act. See id. at § 2(e)(3).
12. See H.R. 988, supra note 1, at § 2(e)(4).
13. See id. at § 2(e)(8).
14. See id. at § 2(e)(6).
15. See id. at § 2(e)(7).
16. See H.R. 988, supra note 1, at § 2(e)(7).
17. See, e.g., 141 Cong. Rec. H2663, H2675 (daily ed. March 6, 1995) (statement of Rep. Harman) (arguing that H.R. 988 "will cause more lawsuits to be voluntarily dismissed and will help restore some efficiency to our Federal legal system").
would reduce the number of meritless claims brought to court. As Mr. Packard argued on the House floor, the Act was meant to "curtail frivolous lawsuits, opening the system to legitimate grievances." According to Mr. Baker, the fee-shifting proposal was crafted to "put a stop to get-rich-quick, lottery-style lawsuits where litigants have little to lose and everything to gain."

In addition, the House expected that the Act would have several secondary effects. First, some members predicted that the Act would reduce so-called "defendant shopping," in which plaintiffs sue many defendants in hopes of finding one with "deep pockets." This practice might, in theory, be reduced if plaintiffs incur additional risks — of paying opposing counsel's fees — for each additional defendant they name. In addition, as its title suggests, the Act was designed to increase responsibility and self-restraint within the legal profession.

A simple example of the fee-shifting mechanism may help to illustrate its intended effect. Assume that a case involves a contract claim for one million dollars. If both parties are risk neutral and each has a different expected value (EV) of the outcome of trial, the case may not settle. For example, if the plaintiff expects to be awarded $550,000 at trial while incurring $100,000 in transaction costs (T), she should be willing to accept an offer as low as $450,000 (EV - T). If the defendant expects the award to be $300,000 after incurring $100,000 in transaction costs, she would be willing to propose an offer as high as $400,000 (EV + T). Because the risk-neutral parties' settlement points are $50,000 apart, analysis suggests that this case would proceed to court.

If the Act were in effect, however, the settlement points might shift enough to create a bargaining range between the parties. Assume that the plaintiff has made an opening offer of $500,000 and that the defendant has countered with an offer of $350,000; without the Act's fee-shifting provision neither party would be willing to settle because each party's expected return from going to court would be

more attractive. The presence of a fee-shifting rule, however, changes each party’s economic assessment of her situation. Under the Act, each party now must incorporate into her calculations the possibility that she will be responsible for the other side’s attorneys’ fees.

The fee-shifting rule drives the plaintiff’s settlement point downward. Specifically, the plaintiff’s settlement point changes from Equation 1 to Equation 2.

Equation 1: \( EV - T \)

Equation 2: \( EV - T - ((\text{Attorneys' Fees of Defendant}) \times (\text{the chance of having the final judgment be less than the offer})) \)

Assuming that the defendant’s post-offer transaction costs will be $100,000 and that the plaintiff believes there to be a 40 percent chance that the final judgment will be less than $350,000, the plaintiff’s settlement point will shift from \( EV (\$550,000) - T (\$100,000) \), or $450,000, to \( EV (\$550,000) - T (\$100,000) - (\text{Fees of Defendant} (\$100,000) \times \text{Chance of Judgment being lower than} \$350,000 (40\%)) \). This equals $410,000.

A similar transformation occurs for the defendant, driving her settlement point higher. If the plaintiff’s post-offer fees will be $100,000\(^2\) and the defendant believes there to be a 25\% chance that the final judgment will be for more than the plaintiff’s offer ($500,000), the original settlement point of $400,000, derived from \( EV (\$300,000) + T (\$100,000) \), becomes \( EV (\$300,000) + T (\$100,000) + (\text{Post-Offer Attorneys' Fees of Plaintiff} (\$100,000) \times \text{Chance of Judgment being greater than} \$500,000 (25\%)) \). Under these circumstances, the defendant’s settlement point rises to $425,000.

The existence of a fee-shifting rule shifts each party’s settlement point enough to create an overlapping settlement range that did not exist previously. In the above case, each party would rather settle somewhere in the range of $410,000 - $425,000 than litigate.

The Act’s intended effect of promoting early settlement may, therefore, be fulfilled in situations similar to the outlined hypothetical. As explained above, however, this illustration of the fee-shifting

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24. In order to simplify the example, we have assumed that the plaintiff and the defendant incur equivalent attorneys’ fees. When the litigants’ attorneys’ fees differ, the Act provides that a litigant is only liable for the other side’s fees up to the amount that the litigant herself spent on attorneys. For example, if the other side incurred $100,000 in attorneys’ fees and the litigant only incurred $80,000 in attorneys’ fees, the litigant is only liable for $80,000 of the other side’s attorneys’ fees. See H.R. 988, supra note 1, at § 2(e)(7).
mechanism has been simplified to demonstrate the Act's intended effect; it is very possible that many of the problems discussed below will prevent the Act from achieving its stated purposes.

The Act was also designed to discourage meritless claims. Theoretically, contingency fee arrangements allow plaintiffs to litigate dubious claims with little risk. If the case is lost, the plaintiff loses nothing and their lawyer absorbs the cost of wasted time and effort. Attorneys working under such arrangements may file claims even if meritless because the potential for a large payoff (whether through erroneous judgment or settlement) compensates for the possibility of loss.25

The proposed fee-shifting rule could help to discourage meritless claims by introducing an element of risk into a plaintiff's decision-making. Instead of bringing risk-free suits, plaintiffs would now have to balance the possibility of gain against the risk of being responsible for the other side's fees. This may filter some meritless claims.

C. Costs

Despite its potential benefits, the Act faced criticism in Congress on at least four grounds. First, some argued that the increased deterrent effects of the revised Rule 68 would be over-inclusive. According to the dissenting Rules and Procedures Committee report, the Act's "fatal flaw . . . is that it does not distinguish between frivolous cases and the much larger class of cases in which liability is a close call."26 Particularly for those cases in which the question of liability is determinative — cases in which the plaintiff expects to receive either a very large judgment or nothing at all — the Act might deter a prospective plaintiff from bringing an otherwise meritorious action for fear of incurring her opponent's high attorneys' fees.

Second, opponents contended that the Act would have the greatest effect on risk averse litigants who could not comfortably carry the

increased risk of attorneys' fees. Moreover, many argued that because less wealthy litigants tend to be risk averse, the Act would disparately impact this group. Thus, assuming that risk aversion generally bears an inverse relationship to a party's resources, the Act benefits the rich.

Third, opponents argued that the Act will not deter frivolous claims. Instead, such claims will be lodged in state courts, which are unaffected by changes to Rule 68. While some held that this forum shift represents an unconstitutional deprivation of the right to federal diversity jurisdiction, most merely employed this argument to attack the Act's practical efficacy.

Finally, the Act's opponents — both Republican and Democrat — argued that it fails to live up to its name; it does little to change lawyers' incentives directly, and instead merely affects litigants' decision-making. Because the costs of the proposed fee-shifting mechanism are borne by the litigants and not their attorneys, it is difficult to imagine how this section of the Act increases "attorney accountability." We take up this subject in more detail below.

III. ANALYSIS OF THE ATTORNEY ACCOUNTABILITY ACT

As shown, the Act's drafters intended to affect litigants' settlement decisions. Influencing settlement dynamics through an incentive-based mechanism, however, may be more complex than the Act's drafters assumed. Various concepts from negotiation analysis —

27. See 141 Cong. Rec. E565 (daily ed. March 9, 1995) (statement of Rep. Stokes) ("H.R. 988 locks the Federal courthouse doors, and gives the rich the key."); 141 Cong. Rec. E542 (daily ed. March 7, 1995) (statement of Rep. Pomeroy) ("This bill alters the playing field between parties to a lawsuit and gives all the benefits to the large financially secure party."); 141 Cong. Rec. H2735, H2747 (daily ed. March 7, 1995) (statement of Rep. Schroeder) ("The goal of deterring frivolous lawsuits is a worthy one. However, H.R. 988's loser pays provision goes well beyond that; it gives a wealthy party the power to slam the courthouse door shut in the face of a middle-income or poor individual with a reasonably strong case.").

28. See H.R. Rep. No. 62, supra note 26, at 29 (dissenting views) ("Because the fee-shifting provision of H.R. 988 applies only in diversity cases, the effect of the rule will be to shift cases to the state courts, rather than to deter them altogether.").


31. See 141 Cong. Rec. H2735, H2746 (daily ed. March 7, 1995) (statement of Rep. Smith) ([T]his bill as currently written does little to make attorneys accountable . . . [U]nder H.R. 988 as currently drafted, attorneys seeking a big, contingency fee payday have an incentive to litigate weak cases aggressively. If the client wins, the lawyer cashes in. If the client loses, the client is stuck with the bill.").
strategic interaction, opportunism and risk preferences, and principal-agent tensions — each provide insight into difficulties the Act may encounter in practice.

A. The Effects of Strategic Interaction

Strategic interaction “arises when two or more individuals interact and each individual’s decision turns on what that individual expects the others to do.” The process requires iterative decision-making: considering one’s actions in light of what one knows about an opponent’s probable actions, what one expects the opponent knows about one’s own actions, and so forth. As John Geanakoplos has noted, “when rational agents interact, they think about what the others know and do not know, and what the others know about what they know, before choosing how to act. Failing to do so can be disastrous.”

This core negotiation concept sheds light on some of the Act’s probable secondary effects. The Act is intended to encourage settlement by raising the potential risks and costs of proceeding to trial. Although the Act was promoted as a tool to discourage meritless claims, many members of Congress recognized that the proposed fee-shifting mechanism could also have a significant impact on risk-averse parties whether or not their claims are justified. Specifically, some feared that deep-pocketed repeat players would take advantage of the proposed rule by offering extremely low settlement proposals very early in the process. Offers as low as $1 could start the “fee-shifting clock” running and induce extremely risk-averse parties to settle regardless of the merits of their case.

To address this problem, Congress added a provision to the Act to provide that attorneys’ fees would be calculated “from the date the last such offer was made or, if the offeree made an offer under this subsection, from the date the last such offer by the offeree was made.” This clause removes the early low offer problem by allowing risk-averse parties to “restart the clock” with the presentation of a

34. See 141 CONG. REC. H2735 (daily ed. March 7, 1995) (statement of Mr. Smith).
counter-offer. Unfortunately, because of the effects of strategic interaction, the provision may diminish the Act's overall effectiveness.

Without the provision, offerors were driven to make a settlement proposal early in the litigation process in order to start the fee-shifting clock ticking as soon as possible. Offerees had incentives to accept these early proposals because rejection exposed them to the risk of having to compensate the other side for its post-offer attorneys' fees. The new provision, however, drastically alters the situation. Because of strategic interaction, the offeror will consider probable moves by the offeree when deciding the timing and amount of an offer. As she will anticipate a "clock restarting" counter-offer eleven days prior to trial, the offeror realizes that she will recover the same level of attorneys' fees regardless of the timing of her initial offer. Likewise, the offeree feels no pressure to accept an early offer, because she recognizes that the timing of the offer has no impact on her future possible liability. Each, in effect, anticipates this "final" move by the offeree eleven days prior to trial. This strategic anticipation eliminates the incentives for early settlement.

This effect is particularly problematic because it vastly reduces the amount of attorneys' fees that are ultimately at stake, and thereby diminishes the Act's impact on the offeree's decision-making process. Although a significant amount of attorneys' fees are generated early in litigation — while writing briefs, engaging in discovery, etc. — these fees will not be recoverable so long as the offeree counter-offers eleven days prior to trial. Thus, in an attempt to protect risk-averse parties from questionable behavior by deep-pocketed repeat players, the drafters may have vitiated the Act.

B. The Effects of Opportunism and Risk Preferences

The Attorney Accountability Act is premised on the assumption that increasing the risks and potential costs associated with trial will promote early settlement and discourage meritless claims. As demonstrated above, the Act assumes that as parties begin to factor fee-shifting risks into their settlement point calculations, a bargaining range will develop, thus encouraging early settlement. In this section we consider the effect of another core negotiation concept — strategic opportunism — on the Act's effectiveness.

36. Note that the counter-offer need not be reasonable, as a plaintiff can "restart the clock" with any counter-offer, including a reinstated demand for the full amount of the claim.
Parties behave opportunistically when they pursue strategies that maximize their own benefit even if their strategy imposes marginally greater costs on the other party. Strategic opportunism describes the well-known fact that many negotiators employ tactics to "claim" value — and grab a larger slice of the proverbial pie — even at the expense of opportunities to create value or "enlarge" the pie.\textsuperscript{37} Although the concept is generally applied to individual negotiations, here we examine the effects of opportunism in situations where a given defendant must negotiate with many different plaintiffs over time.

In such cases, as some commentators have noted, increasing the level of risk associated with trial — for example, by adding the risk of having to compensate the other side for attorneys' fees — can have the counter-intuitive effect of decreasing the number of early settlements.\textsuperscript{38} When deep-pocketed repeat-player defendants negotiate with one-shot plaintiffs — the typical tort case brought by an individual against a large corporation — increased levels of risk may encourage defendants to offer low-ball settlements in order to sort plaintiffs and benefit from risk-averse individuals.\textsuperscript{39}

Repeat players may behave opportunistically in such situations by calculating their costs and benefits across all of the cases in which they are involved. To maximize their returns, they may low-ball with most plaintiffs in hopes of getting low-cost settlements with at least some. Although this tactic would aid the repeat player over time, it would also increase the number of cases going to trial because many plaintiffs will reject the repeat player's seemingly hardball demands. Nevertheless, if enough risk-averse plaintiffs will settle for meager payments, the lowball strategy will compensate for the extra trial costs that the defendant incurs.

An example will clarify this point. Assume one hundred different tort cases are brought by one hundred different plaintiffs against a single corporation, with each case claiming $1 million in damages. If both the plaintiffs and the defendant assume that the expected value (EV) of each trial is $300,000, and each party anticipates that $50,000 will be spent in transaction costs (T) by each side in each

\begin{itemize}
  \item \textsuperscript{37} See David A. Lax & James K. Sebenius, The Manager As Negotiator: Bargaining for Cooperation and Competitive Gain 158 (1986).
  \item \textsuperscript{38} See Amy Farmer & Paul Pecorino, Pretrial Negotiations With Asymmetric Information on Risk Preferences, 14 Int'l Rev. L. & Econ. 273, 273–74 (1994) (arguing that factors which increase risks of trial may actually lead to fewer pre-trial settlements due to strategic behavior of defendants).
  \item \textsuperscript{39} See id. at 274–76.
\end{itemize}
case, then a risk-neutral plaintiff should be willing to settle the case for $250,000 (EV - T). A risk-averse plaintiff, however, would be willing to settle for less in order to be assured some payment.

If the defendant corporation cannot predict in advance which plaintiffs are risk neutral and which are risk averse, the defendant's settlement strategy may rest on its estimate of the risk-averse plaintiff's settlement points. If the differential between the lowest offer that a risk-neutral plaintiff will accept ($250,000) and that which a risk-averse plaintiff would accept ($230,000) is small ($20,000 in this case), then the defendant will most likely offer all plaintiffs the higher figure to avoid trial costs. This strategy will result in a high level of pre-trial settlements.

If, however, there is a great deal of risk associated with the trial, and the defendant could extract a relatively large premium from risk-averse plaintiffs (since they do not want to incur this risk), then the defendant corporation may pursue a very different strategy. Assume that some number of plaintiffs are extremely risk averse. Assume also that although the expected value of the trial is $300,000, a wide range of potential outcomes creates the possibility, although slight, that the plaintiff will receive nothing. Some risk-averse plaintiffs may be willing to accept extremely low settlement offers — such as $30,000 — to avoid facing the risks associated with trial. If there is sufficient risk associated with the trial so that the differential between that which the risk-neutral plaintiffs are willing to accept ($250,000) and that which the risk-averse plaintiffs are willing to settle for ($30,000) is great ($220,000 in this case), the defendant may pursue a lowball strategy of offering all of the plaintiffs $30,000. Although this will result in more of the cases going to trial, the defendant will have profited from the risk aversion of some plaintiffs, compensating it for the additional cost of going to trial in some cases.

The hypothesis that an increased level of risk associated with trial will lead to fewer settlements has serious implications for fee-shifting statutes. If the Act succeeded in changing individual party's decision analysis, this could result in fewer pre-trial settlements if

40. See id. at 275.
41. This assumes, of course, that the defendants believe there to be a sufficient number of risk-averse plaintiffs to render the strategy profit maximizing.
42. This hypothesis should hold true even under a multi-period scenario in which the defendant can vary its offers in different periods. For example, although in theory a defendant could make a low settlement offer at first and then raise the offer if the plaintiff rejected it, this strategy would unravel if used against many plaintiffs because the defendant would acquire a reputation for bluffing.
repeat-player defendants pursue a "sorting" strategy. Furthermore, the plaintiffs who found themselves forced to settle for extremely low figures would not necessarily be those individuals with the least valid claims. Instead, those parties who simply possessed the least tolerance for risk would accept extremely low settlement offers, regardless of the merits of their case. This potential outcome not only contradicts one of the stated purposes of the Act — to reduce the court docket and encourage early settlement — but also results in the manifestly unjust result of penalizing those parties (usually poor or middle income individuals) who fear risk.

C. Principal-Agent Problems

Negotiation analysis of principal-agent relationships provides a third lens through which to consider the Attorney Accountability Act. Principal-agent relationships involve the delegation of certain authority or responsibilities from the principal to the agent. Because clients often ask their lawyers to negotiate on their behalf, legal disputes commonly involve complex principal-agent dynamics.

Such relationships confer numerous benefits upon both agent and principal, particularly because agents commonly have specialized knowledge, resources, or skills that principals lack. This is particularly true in attorney-client relationships. Nevertheless, principal-agent relationships also introduce potential problems. In theory, an agent is delegated authority to "do the principal's bidding." In practice, however, principals and agents can differ on three fundamental issues: incentives, information and preferences. An opportunistic agent can exploit these differences in order to satisfy their own, rather than their principal's interests.

The Act's failure to address such principal-agent problems directly may have several important consequences. First, because the Act merely changes the principal's incurred risk and not the agent's, it may have little effect on settlement decisions if the agent heavily


44. The legal definition of an agency relationship is straightforward. "Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other to so act." Restatement (Second) of Agency § 1 (1958).

influences or is in control of the decision-making process. The Act may convince a fully-informed plaintiff — as principal — that the risk of having to compensate the other side's attorneys' fees is sufficient to warrant settlement. If the plaintiff delegates decision-making authority to his lawyer, however, or the lawyer strategically withholds relevant information regarding the settlement decision, this risk may not come into play. Because the Act in no way alters the incentives of the lawyer, it may fail to encourage settlement.

The extent to which lawyers control their clients' decision-making is, of course, an empirical question, and one about which we have little data. All lawyers may not enjoy a level of independence that enables them to make decisions contrary to their clients' interests, and even very independent attorneys will undoubtedly often remain faithful to their clients' interests. This will not always be the case, however. Some attorneys cheat.

Further, it is important to remember that the Act attempts to influence settlement behavior by changing only one variable: the parties' transaction costs. Transaction costs are squarely within the agent's domain: they are one thing about which an agent almost certainly knows more than the principal. Thus, for example, a lawyer will be more able than her client to estimate what fees will likely be incurred throughout litigation. Under the Act, of course, a litigant would need to estimate the other side's likely attorneys' fees in order to factor the burden of paying those fees into the litigant's settlement decision. Again, it seems reasonable to assume that clients will turn

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46. Lawyers are often accused of delaying or preventing settlement in order to increase their personal financial gain. In class actions, for example, representative attorneys may reject a settlement that offers inadequate attorney compensation in favor of trying the case in court where attorneys' fees are virtually guaranteed. See Deborah L. Rhode, Class Conflicts in Class Actions, 34 Stan. L. Rev. 1183, 1204–15 (1982); see also Robert H. Mnookin & Robert B. Wilson, Rational Bargaining and Market Efficiency: Understanding Pennzoil v. Texaco, 75 Va. L. Rev. 295, 299 (1989) (identifying an agency problem in which the officers and directors of Texaco preferred to pursue litigation to seek complete vindication rather than settle, which would have satisfied the interests of the company's shareholders — their principals).


47. As Paul Milgrom and John Roberts have pointed out, "the agent's interests commonly differ from the principal's and the principal cannot evaluate how well the agent has worked or whether the agent has been honest." Paul Milgrom & John Roberts, Economics, Organization and Management 195 (1992).
to their attorneys for such estimates. Moreover, because the Act provides that a litigant can only be liable for the other side's fees up to the amount that the litigant herself spent on attorneys, the lawyer's estimate of his own fees remains fundamentally important. It seems very likely, therefore, that litigants — particularly individual, inexperienced litigants — will simply ask their lawyers to keep the effects of the Act in mind; in short, they will delegate to the lawyer responsibility for estimating costs. Again, because the lawyer may have independent incentives, the Act may not ultimately lead the parties to settle any earlier than they would have before the Act was passed.

In addition, principal-agent problems might increase, rather than decrease, the number of meritless claims brought. Consider the situation from the perspective of a plaintiff's attorney. With the Act in effect, risk-averse plaintiffs might now settle their cases earlier, and for less money. Although a lawyer may not have to expend much effort to reap the returns of such quick settlements, smaller settlements mean lower total returns for the lawyer if he or she works on a contingency basis. Viewed broadly, rather than at the level of an individual case, what systemic incentive does this create for the attorney? We might predict that if an attorney's return per case drops, she will have an incentive to bring more, not fewer, cases. Where will these cases come from? Most likely, these cases will come from the

48. This delegation of decision-making seems particularly probable when an individual plaintiff has hired an attorney on a contingency fee basis but requires an estimate of the defendant's incurred attorneys' fees, which were most likely billed at an hourly rate. Given that the plaintiff is likely to be unfamiliar with the rates charged by defense counsel or the amount of time that defense work requires, the plaintiff's lawyer will generally have to assume responsibility for making this estimate.

49. See H.R. 988, supra note 1, at § 2(e)(7).

50. It is worth mentioning that fee structures will play a crucial role in determining how the proposed legislation affects lawyers' incentives. On the plaintiff's side, a contingency fee arrangement that subtracted incurred costs prior to calculating the attorney's percentage could, theoretically, reduce the lawyer's incentive to withhold information about the Act's effects. (This would only hold true when the lawyer believed there to be a risk of the plaintiff winning but receiving a judgment for less than the defendant's final offer). Conversely, a contingency arrangement that did not subtract costs prior to fee calculation would force the litigant to bear the total cost of the Act's fee-shifting, and would have little or marginal effect on the attorney's incentives. Likewise, an hourly fee structure does little to align the divergent interests of lawyers and their clients. A defense firm, for example, would have little economic reason to inform its client about the Act's risks if the client would ultimately bear the burden and continuing litigation would benefit the firm through increased billing. We note, of course, that these principal-agent dilemmas raise difficult questions of ethics and professional responsibility well beyond the scope of this comment.
vast pool of meritless claims that the Act was intended to deter.\textsuperscript{51} The Act thus might \textit{increase}, rather than decrease, the overall volume of undesirable litigation.

We do not wish to overstate the effect of these principal-agent problems. The Act targets litigants' pocketbooks and would certainly alter plaintiffs' decisions. The Act overlooks, however, the important incentive and information problems inherent to principal-agent relationships. As a result, it does little to render attorneys more accountable to their clients or to the courts. Instead, the Act's real impact will be felt mainly by attorneys' principals, the litigants.

IV. CONCLUSION

Our review of the Attorney Accountability Act suggests various shortcomings of this type of incentive-based legal reform. The effects of strategic interaction, opportunism and risk preferences, and principal-agent problems, raise questions as to whether the Act would succeed if passed. Our application of these negotiation concepts suggests that changing litigants' behavior is more complicated than the Act's proponents predicted, and thus our analysis raises doubts about the general efficacy of incentive-based reform.

\footnote{51. We wish to emphasize that we do not necessarily share H.R. 988's root assumption that plaintiffs' lawyers are willing or eager to bring claims that they believe to be meritless. Our point here is merely that \textit{on its own terms} H.R. 988 may create the opposite incentives of those sought by the Bill's drafters.}