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Pretrial negotiation behind open doors versus closed doors: Economic analysis of Rule 408

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Abstract

In this paper, we examine the economics of Rule 408 of the Federal Rules of Evidence, whereby the negotiation processes at the pretrial stage are made inadmissible to prove the amount of liability. It is asserted that under Rule 408 a settlement offer is less inclined to be rejected since the judge is expected to make a lower award given the signal he observes. Also, we derive a sufficient condition for Rule 408 promoting settlement. © 2000 Elsevier Science Inc. All rights reserved.

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1. Introduction

The litigiousness of American society has been a growing social concern. Time-series data show that, over the course of the 20th century, there is an upward trend in civil cases filed as percentage of the population in many American jurisdictions.¹ This has recently drawn the attention of economists as well as legal scholars into the area of litigation process.

Many legal devices have been designed to reduce court congestion and legal expenditures. These devices include fee-shifting rules such as Rule 68 of the Federal Rules of Civil

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¹ See Galanter (1983).

Procedure,² discovery requirements,³ a shift in a certain tort from a rule of negligence to a rule of strict liability⁴ and Rule 408 of the Federal Rules of Evidence.⁵ The purpose of this paper is to examine whether Rule 408 of the Federal Rules of Evidence can promote settlement and thus reduce the number of actual trials.

The idea of protection against the admissibility of conducts made in compromise negotiations goes back prior to the adoption of the Federal Rule of Evidence in 1975. The rationale relied upon by courts at common law in excluding evidence of the actual compromise offer was that they were irrelevant to the substantive issues; such conduct implied merely a desire for peace, not a concession of weakness of position. Another rationale was that it was improving social welfare to encourage the out-of-court resolution of disputes (Brazil, 1988). To promote this purpose, the Advisory Committee, in drafting Rule 408, expanded its range of protection considerably; specifically, the rule offered protection not just to offers or demands, but also to conduct or statements made in compromise negotiations.

Economic analysis of Rule 408 was first attempted by Daughety & Reinganum (1995). By analyzing a model where the informed plaintiff makes a take-it-or-leave-it offer, they show that making a pretrial demand admissible will increase the expected number of cases that go to trial, since the defendant must reject the plaintiff's offer more often in order to counteract the plaintiff's incentive to inflate their demand with intent to influence the judge's beliefs under admissibility. However, we think that their analysis of Rule 408 is partial, in the sense that it only involves the effect of protection against the admissibility of pretrial demands. The analysis would be completed when one considers the effect of protection against admissibility of other kinds of conduct made in compromise negotiations as well.

In this paper, we will show that Rule 408 can increase the rate of settlement by making inadmissible the pretrial evidence that settlement offer of a certain amount has been rejected by the plaintiff, in an alternative model where the uninformed defendant makes a take-it-or-leave-it offer.⁶ The intuitive reason is that a plaintiff would be more likely to reject the defendant's settlement offer to influence the judge's belief on his damage amount upward

² The rule requires that if a plaintiff rejects a settlement offer and is later awarded a less favorable judgment at trial, he compensates the defendant for certain costs incurred by the defendant after the offer has been made. For an economic analysis of Rule 68, see Spier (1994).

³ For an economic analysis of mandatory discovery, see Sobel (1989).

⁴ The negligence rule requires the plaintiff to prove an additional element (the defendant's negligence), which is usually the private information of the defendant. Thus, adopting the strict liability rule might reduce the information asymmetry between the parties and consequently increase the likelihood of settlement. However, some also argue that this may actually increase the number of cases filed because it is easier to prove a claim under strict liability.

⁵ Rule 408 provides that evidence of (a) furnishing or offering or promising to furnish, or (b) accepting or offering or promising to accept a valuable consideration in compromising or attempting to compromise a claim that was disputed as to either validity or amount, not be admissible to prove liability for or invalidity of the claim or its amount.

⁶ Daughety & Reinganum (1993) discuss endogenous sequencing in settlement negotiations. Unfortunately, their result supports neither the model of Daughety & Reinganum (1995) nor ours, in which only the plaintiff has private information.

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