Federal Courts Committee
Report on Rule 68 of the Federal Rules of Civil Procedure

Introduction

As part of its 2012 review of issues relating to the settlement of cases in federal court, the Mediation and Settlement Subcommittee of the Federal Courts Committee studied Federal Rule 68[1] to determine whether amendments to the Rule would enhance its effectiveness in encouraging settlement of cases. In its current form, the Rule is considered largely toothless and rarely used (with some exceptions as discussed below). The Subcommittee prepared this report to summarize the results of its research and analysis and to promote discussion within the bar.

Although Rule 68 was presumably designed to encourage settlements of civil cases, it provides little incentive to do so, since the only consequence - - with certain exceptions - - of rejecting an offer of judgment under the Rule and subsequently recovering less at trial, is liability for the offeror's taxable costs, a nominal portion of litigation expense. The primary

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[1] Rule 68 provides:

(a) MAKING AN OFFER; JUDGMENT ON AN ACCEPTED OFFER. At least 14 days before the date set for trial, a party defending against a claim may serve on an opposing party an offer to allow judgment on specified terms, with the costs then accrued. If, within 14 days after being served, the opposing party serves written notice accepting the offer, either party may then file the offer and notice of acceptance, plus proof of service. The clerk must then enter judgment.

(b) UNACCEPTED OFFER. An unaccepted offer is considered withdrawn, but it does not preclude a later offer. Evidence of an unaccepted offer is not admissible except in a proceeding to determine costs.

(c) OFFER AFTER LIABILITY IS DETERMINED. When one party's liability to another has been determined but the extent of liability remains to be determined by further proceedings, the party held liable may make an offer of judgment. It must be served within a reasonable time—but at least 14 days—before the date set for a hearing to determine the extent of liability.

(d) PAYING COSTS AFTER AN UNACCEPTED OFFER. If the judgment that the offeree finally obtains is not more favorable than the unaccepted offer, the offeree must pay the costs incurred after the offer was made.

exception stems from the U.S. Supreme Court holding in *Marek v. Chesny,* 473 U.S. 1 (1985), that where a statute, such as 42 U.S.C. § 1983 and Title VII of the Civil Rights Act, defines recoverable costs to include attorneys' fees, a plaintiff who rejects an offer of judgment and then recovers less at trial loses the right to recover attorneys' fees incurred post-rejection (but is not obligated to pay the defendant's attorneys' fees).

Ultimately the Committee voted to recommend to the Advisory Committee on the Civil Rules that Rule 68 be amended to make it available to plaintiffs as well as defendants, and rejected a proposal that would have made attorneys' fees part of the costs potentially shifted under the Rule. Because the Committee was closely divided on the latter proposal, and because it raises substantial philosophical issues about which Association members may have strong views, we hope that posting this Report will benefit the Association by providing an overview of the Rule and several issues arising under it, including the pros and cons of amending it to include a fee-shifting provision.

Rule Symmetry

Plaintiffs are not permitted to make offers of judgment under the current version of Rule 68. Twenty-three states (but not New York) have adopted some variation of a two-way rule.

No articulated rationale for the current one-way regime was found in the sparse legislative history of the Rule. The Committee endorsed making the Rule symmetrical as a matter of fairness - - as it would give plaintiffs the same leverage currently available only to defendants - - and potentially to increase the Rule's use. However, unless attorneys' fees become part of recoverable costs, or some multiplier of costs is included, making Rule 68

available to plaintiffs would not confer any additional benefit on them, because the costs awarded under a Rule 68 scenario would be no more than the costs already recoverable by prevailing plaintiffs under Rule 54. (In contrast, defendants do benefit from Rule 68 since without it, their costs are not recoverable if a plaintiff recovers a judgment of any amount at trial.) Thus, this rule change will be meaningful only if accompanied by either an increase in the costs recoverable by plaintiffs, or an attorneys' fee-shifting provision.

Attorneys' Fees

Amending Rule 68 to include as part of recoverable costs the attorneys' fees incurred by the offeror following the rejection of a Rule 68 offer of judgment would significantly raise the stakes involved in weighing such an offer, and thus would encourage early settlement of cases, in turn enhancing the efficiency of litigation. Supporters of such a change note that it would deter plaintiffs from pursuing marginal claims beyond the point where the costs of litigation outstrip any potential recovery, and - - if the Rule were made symmetrical - - deter defendants from using superior resources to "wear out" plaintiffs.

To prevent potential injustice resulting from fee-shifting under the Rule, supporters suggest that (i) fee-shifting be inapplicable unless the offeree's recovery at trial is a certain percentage below the rejected offer; and (ii) district courts be given considerable discretion to modify or deny fee-shifting based on the facts and circumstances of a given case. By way of example, Alaska's counterpart to Rule 68, Alaska R. Civ. P. 68, contains these two elements, providing:

- An award of "reasonable actual" post-offer attorneys' fees to the offeror is triggered when the judgment at trial is 5-10% (depending on whether or not there are multiple defendants) less favorable than the refused offer.
- Courts are given discretion to deviate from the guidelines and adjust attorneys' fees based on: (i) the complexity of the litigation, (ii) the length of trial, (iii) the reasonableness of the attorney's rates, hours expended, attorneys used, and attorney's efforts to minimize fees, (iv) the reasonableness of the claims and defenses pursued by each side, (v) bad faith, (vi) the amount of work performed and the significance of the matters at stake, (vii) the extent to which an overly onerous fee would deter future litigants, and (viii) other equitable factors.

California's counterpart to Federal Rule 68, Cal. Civ. Proc. Code § 1021, also requires trial judges to consider the following multiple factors in deciding whether to award attorneys' fees to the offeror following a judgment at trial less favorable than the rejected offer:

- The reasonableness of the offeree's failure to accept the offer, including: (i) the merit or lack of merit of the claim; (ii) the closeness of the questions of fact and law; (iii) whether the offeror has unreasonably failed to disclose relevant information; (iv) whether the matter was considering a question of significant importance that the court had not yet addressed; (v) relief that might reasonably have been anticipated, given known information at the time of the offer; and (vi) the amount of additional delay, cost and expense that the offeror reasonably would be expected to incur if the litigation should be prolonged;
- The amount of damages and other relief sought and the results obtained;

- The efforts made by the parties or the attorneys to settle the controversy; and
- The existence of any bad faith or abuse of legal procedure by the parties or the attorneys.

Some supporters of fee-shifting recommend that discretion similar to that afforded to state trial judges in the above-described statutes accompany any amendment to Rule 68 that incorporates a fee-shifting mechanism. In this regard, the existence of a statutory fee-shifting mechanism applicable to the underlying claim (i.e., civil rights or employment discrimination) might be a factor militating against awarding the defendant some or all of the fees it would otherwise be entitled to. Conversely, if plaintiffs become entitled to make offers of judgment in Title VII or § 1983 cases, to make the rule truly symmetrical they would have to receive a "premium" on their recovery of attorneys' fees if they obtained a judgment in excess of a rejected Rule 68 offer.

In sum, supporters believe that adding "teeth" to Rule 68 in the form of liability for a portion of an adversary's attorneys' fees will force parties to evaluate their cases more seriously and objectively at an earlier stage in the litigation, and will save parties the substantial attorneys' fees they are forced to incur under the current system, either to defend borderline-frivolous claims or to prosecute meritorious claims that deserve reasonable settlement offers, while the ample discretion recommended to be given to trial judges will protect parties from unjust application of the rule.

In contrast, those with the opposing viewpoint strongly believe that incorporating fee-shifting into Rule 68 will put undue pressure on plaintiffs in particular to accept low offers of judgment, rather than risk being saddled with the defendant's attorneys' fees if the factfinder

at trial awards less than anticipated; accordingly, a party's right to a trial will, as a practical matter, be restricted (much as prosecutorial leverage causes many criminal defendants to accept a plea bargain rather than risk going to trial). In circumstances applying a modified Rule 68, the "American rule" long established in our jurisprudence - - which leaves each party responsible for its own attorneys' fees, win or lose, unless a relevant statute provides otherwise - - would be undone. Moreover, giving district courts discretion to modify the Rule will create a new layer of post-trial litigation and expense as parties attempt to influence the exercise of that discretion.

Other opponents emphasize that one of the rights of American citizens is to have their disputes decided by an impartial judge. A litigant or prospective litigant may voluntarily waive that right by, for example, agreeing to submit disputes to arbitration; a contracting party may elect to enter into an agreement that awards fees to the prevailing party in a dispute. But it is quite a different matter to tell litigants that part of the risk they run in seeking a judicial determination of their rights is that the other side may try to force them to settle prematurely, and at a level other than one they deem appropriate, by the simple device of making a Rule 68 offer which is coupled with the threat of shifting attorneys' fees. Building that into the system may well discourage litigants from seeking relief for genuine harms.

Opponents further note that not every litigation is brought or defended solely for money, nor even for an injunction. A fair amount of litigation is brought, or defended, for purposes of obtaining vindication, to act as a test case, or for other legitimate purposes. It is unfair to litigants who are not necessarily litigating solely for money to, in effect, fine them for exercising their right to obtain their legitimately sought objectives through the litigation

system. Libel plaintiffs, for example, or civil rights plaintiffs often care more about simply getting a judgment than about the amount they recover.

Other arguments against a fee-shifting provision include the following:

- Promoting settlement is most assuredly a legitimate policy objective in the federal court system, but it is not the primary objective. The proponents of fee-shifting have not explained why this policy is so much more important than other considerations that it warrants imposing the risk of large costs on litigants who want nothing more than to have their cases decided - - which is, after all, what the court system exists to do. There are institutional considerations, especially caseload-related considerations, that make settlement promotion an important policy. But the solution to large caseloads is more judges, not increasing the stakes in litigation to a level even higher than they are now. The main purpose of courts is to do justice, and a proposed rule that downgrades the rendering of justice as a goal is not a rule that lawyers should be recommending.
- Providing for judicial discretion to mitigate the potential harshness of such a rule is not a workable solution. For one thing, the expense of litigating how the judge should decide such a motion would itself drive up the costs. For another, the discretionary escape hatch will be yet another occasion for satellite litigation. If one reason to promote settlements is to ease the demands on the court system, this rule will not do so if it just creates one more arena for contention.
- Such a rule may operate to increase the acrimony of cases that don't settle, because litigants then need not only to win, but also to "beat the spread."

- Inasmuch as somewhere in the neighborhood of 95% of civil litigations settle, this may well be a solution in search of a problem. Arguably, some number of the cases that do settle should have settled earlier, but absent some fact-based demonstration that this causes some serious deterioration in the overall quality of justice in the federal courts, this is hardly a sufficient justification for seriously altering the dynamics of litigation.

Additional Issues Concerning Rule 68

Although they did not result in formal recommendations to the Committee, the Subcommittee also identified several additional issues worth noting, which are summarized below.

- **The *Delta Air Lines* Decision**

In ***Delta Air Lines, Inc. v. August*, 450 U.S. 346, 351 (1981)**, the Supreme Court held Rule 68's mandatory cost-shifting inapplicable to cases where the defendant prevails entirely, holding that under the Rule's plain language it applies only when a plaintiff "has obtained" a "judgment," *i.e.*, recovered a judgment in some amount. Where the defendant is the prevailing party, it may seek to recover costs in the court's discretion under Rule 54(d).

The dissent and some commentators criticize the holding as perverse for placing defendants who prevailed entirely (and thus were entitled to costs only in the court's discretion under Rule 54(d)) in a worse position than defendants in cases where the judgment obtained by plaintiff was less favorable than the defendant's offer (thus triggering mandatory payment of costs under Rule 68); this camp argues that "judgment obtained" by plaintiff does not necessarily mean "favorable judgment."

Delta supporters counter that were Rule 68 applied to situations where defendant has prevailed, defendants could always circumvent courts' discretion under Rule 54(d) to award costs, simply by making nominal offers under Rule 68 and later invoking that Rule's mandatory cost-shifting provision.

- **Allowing Offers of Settlement (vs. Offers of Judgment) to Trigger the Rule**

As currently drafted, Rule 68 provides that a defendant may offer in writing to have a "judgment" entered against it on specified terms. A simple settlement offer does not trigger Rule 68; only a formal written offer of judgment suffices. Insofar as an objective of Rule 68 is to promote settlements, providing that the rule is triggered by any settlement offer might potentially serve to promote this goal. Due consideration to Federal Rule of Evidence 408 would still be needed.

Arguments in favor of this change include:

- The prospect of paying the defendant's costs if the ultimate decision is less favorable than defendant's offer increases the plaintiff's risks in declining an offer, and thus may make settlement more likely. Therefore, attaching to every settlement offer the prospect of cost-shifting promotes settlement by making a refusal to settle more risky and thus more expensive.
- Certain settlement structures may not be easily amenable to being reduced to judgment. This is particularly the case with confidential settlements and settlements that involve conditional obligations. Changing the rule may promote settlement by allowing more complex settlement transactions to be covered by the rule.

Arguments against such a change point out that by adding increased risk to any settlement discussion, the proposal may lead in some cases to a refusal even to discuss settlement at early stages in the case. This may be especially true if the rule is changed to permit reciprocal offers.

Moreover, it will not always be clear whether the settlement proposal was more favorable than the ultimate judgment, particularly when there are multiple possible outcomes on multiple claims. In addition, the ability to obtain a judgment may itself be an issue, for example, where the offer is not accepted because defendant specifically wants no judgment to be entered and the plaintiff insists on entry of a judgment. If the final judgment is for fewer dollars than the offer, it is not necessarily the case that that outcome is less favorable than the offer.

- **Including E-Discovery Cost-Shifting Under Rule 68**

In the Southern District of New York, a prevailing party cannot recover e-discovery costs pursuant to the general federal costs statute, 28 U.S.C. § 1920. See S.D.N.Y. Local Civil Rule 54.1(c). However, some courts outside of the Second Circuit have permitted a party entitled to cost-shifting under Rule 68 to recover e-discovery costs. While the cost of "copying" electronic documents (in contrast to searching for or reviewing them) is minimal, some courts have been interpreting electronic "copying costs" expansively, e.*g. CBT Flint Partners, LLC v. Return Path, Inc.*, 676 F. Supp. 2d 1376 (N.D. Ga. 2009), *vacated on other grounds and remanded*, 654 F.3d 1353 (Fed. Cir. 2011). However, the first appellate court to address the issue recently rejected this approach. *Race Tires America, Inc. v. Hoosier Racing Tire Corp.*, 674 F. 3d 158, 160 (3rd Cir. 2012).

Proponents of including e-discovery costs as part of the costs shifted under Rule 68 argue that it would increase the incentives to accept a Rule 68 offer, and encourage litigants to seek only necessary discovery.

Opponents of such a change point out that it (i) could have the opposite effect of encouraging unnecessary e-discovery in the hope of convincing an adversary to accept a Rule 68 offer; (ii) would increase "satellite litigation" because courts would have to determine the reasonableness of various e-discovery costs sought by the Rule 68 offeror; (iii) would potentially create confusion among practitioners as to costs recoverable under 28 U.S.C. § 1920 versus costs recoverable under Rule 68; and (iv) contravenes the intent of Rule 68's drafters, who could not have envisioned/intended that the "copying" costs to be imported from Section 1920 would encompass the enormous costs of contemporary e-discovery.

Conclusion

As noted at the outset, the Committee hopes that this Report, and particularly the summary of arguments for and against the addition of a fee-shifting provision to Rule 68, will provoke thought and promote discussion within the bar. In further aid of this goal, a bibliography of relevant commentary and case law is attached to this Report.

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