Jury verdicts, settlement behavior and expected trial outcomes☆

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ABSTRACT

The expectations that litigants hold about what would happen if they took their case to trial drive settlement behavior. Jury verdicts from previous trials provide information that could be used to help set beliefs about the potential damage award that would be granted in a dispute if it were to go to trial. But if past jury verdicts do have an impact on litigant beliefs then growth in observed awards could alter behavior in ways that change which cases ultimately get resolved at trial. In other words, the average jury award today could influence the set of cases we see at trial in the future. This paper derives and tests some empirical predictions about how past verdicts change the number of future trials and the expected trial outcomes. The findings suggest that recent verdicts alter the settlement behavior of litigants, making them more likely to proceed to trial with lower value cases.

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1. Introduction

One aspect of the civil justice system that economists have found particularly ripe for study is the litigation process. Settlement negotiations involve bargaining under uncertainty between two or more agents with directly conflicting objectives, a situation that lends itself well to economic modeling. A key parameter of any litigation model is the *ex ante* expected jury award that a plaintiff in a dispute would receive if the case proceeded to trial and was decided by a jury. However, despite the theoretical importance of litigant expectations in driving settlement behavior, we have relatively little knowledge about how expectations are actually formed.

One natural source of information about expected jury awards in current disputes is the set of awards that resulted from past trials. We might expect that rational litigants would look at past jury awards and use the information contained there to calibrate their expectations. However, most cases settle without being resolved at trial. Moreover, most settlement models predict systematic differences in the kinds of cases that go to trial compared to those that settle.[1] The comparatively small number of verdicts that occur

suggests that even highly experienced litigators might have limited knowledge upon which to base expectations about potential trial outcomes. While this highlights the importance of past trials as a potential source of information, it also raises a key question: do past verdicts influence litigant behavior in ways that change the expected level of awards observed in future trials?

In this paper I use historical data on civil jury verdicts to test the impact of average awards on future trial outcomes. Specifically, I regress the jury award in an individual case in year t against the average award from similar cases in the same jurisdiction in the previous year. The data suggest that there is a negative year-to-year relationship between past and present trial outcomes. The regression results suggest that a \$1000 increase in the average award in the previous year is associated with \$2–\$20 lower expected award amounts in similar cases in the same county in the current year. These results are robust to numerous specification and robustness checks. However, the findings are specific to case type. That is, past growth in the average award for one type of case has little predictive value for average awards in other case types in the current year.

I discuss several possible explanations as to why current verdict award amounts are negatively correlated with verdicts from past years. One possibility is that past awards change peoples' expectations about the cost of litigation and this causes them to change their behavior in ways that reduce the frequency and severity of accidents—that is, it increases the deterrence effect of liability. Another possibility is that increases in average awards raise litigant expectations about the value of going to trial and induces them to go to trial with less valuable cases. Finally, a third possible explanation that is unrelated to changes in individual expectations is the possibility that large jury awards introduce bias to juries or judges. That is, if large awards cause local citizens to feel that the court

[1] First discussed by Priest and Klein (1984), the nonrandom selection of cases to go to trial is called the "selective litigation hypothesis." It has been supported by empirical work such as Eisenberg (1990), Eisenberg and Farber (1997) and Waldfogel (1995).

system is littered with "out-of-control juries" it could induce them to grant smaller awards when they become jurors themselves.

While each of these explanations is consistent with a negative relationship between past jury awards and the expected award in future trials, they have different implications for the relationship between past verdicts and the number of new verdicts. The deterrence theory relies on the notion that potential injurers become more careful in the face of rising verdicts, which should lower awards in new cases but also result in fewer disputes and fewer verdicts. The bias model would also weakly predict a decline in the number of verdicts. In contrast, the settlement model predicts that an increase in expectations about verdicts would make litigants less willing to settle, resulting in an increase in the number of verdicts. I test the relationship between past verdicts and the number of trials and find a positive relationship. This does not rule out the possibility of enhanced deterrence or bias, as they are not mutually exclusive of the settlement model. However, it does indicate that increases in average jury verdicts have tangible effects on future settlement behavior, making litigants (plaintiffs in particular) more willing to proceed to trial with relatively less valuable cases.

The paper proceeds as follows. The next section outlines a conceptual framework for analyzing the relationship between past jury verdicts and current expectations. Section 3 outlines the empirical approach and describes the data. Section 4 presents the results. I conclude with a discussion of the implications of the findings, limitations and suggestions for future research.

2. Conceptual framework

A hallmark of economic models of the US legal system is that potential litigants negotiate "in the shadow of the law," meaning that they negotiate a settlement based on their expectations about what would happen if the case proceeded to trial (Cooter, Marks, & Mnookin, 1982; Mnookin & Kornhauser, 1978). Because of this, expectations about potential jury awards represent a key parameter in most law and economics models. But how are beliefs about potential trial outcomes in civil cases formed? If observed jury awards influence the expectations of potential litigants, it could alter their behavior in ways that ultimately change the set of cases that are resolved at trial. In other words, the outcomes we observe in cases resolved at trial today could be endogenously determined by what we observed occurring in trials in the past.

In this section I compare and contrast three alternative behavioral responses that could generate a relationship between past and present jury verdict awards. The first is that changes in expectations influence behavior prior to an event resulting in a dispute by changing the level of deterrence. The second is that changes in expectations systematically change the set of disputes that are resolved at trial by influencing settlement behavior. The third is that past verdicts have a causal impact on the award in a given case by creating biases in jurors (or judges). While none of these models are mutually exclusive and they share some common predictions, there are some distinctions that I outline below.[2]

2.1. Changes in deterrence

The first possibility I consider is that changes in expected awards cause a change in the underlying set of disputes. This could occur if

an increase in the potential level of liability led to increased deterrence. That is, if higher potential liability increased the expected cost of risky behavior, it could cause individuals to invest more in safety and affect the set of cases that get resolved at trial.

The standard model of deterrence considers two parties, the injurer and the injured.[3] The injurer takes some activity level x that imposes harm $h(x)$ on the injured, where $h'(x) > 0$. The tort system views excessive activity levels as negligent, and imposes damages $D(x) = h(x)$ on activity levels that exceed the reasonable threshold x^*. Suppose that the gross benefit to the injurer of the activity level is x and that the marginal cost (ignoring liability) is 0. In this case it is straightforward to see that the injurer will select activity level $x = x^*$ if $h'(x^*) > 1$ and $\tilde{x}$ such that $h'(\tilde{x}) = 1$ otherwise.

Now, suppose that the actual harm suffered by the injured is uncertain *ex ante*, and unknown to the injurer and injured until the level of x is chosen and the actual harm is experienced by the injured. Suppose that $E[D|x]$ represents the injurer's expected liability from harm conditional on x. If $\partial E[D|x*]/\partial x \geq 1$, then $x = x^*$. On the other hand, if initially the injurer's expectation of harm is such that $\partial E[D|x*]/\partial x < 1$ then $x > x^*$ and the injurer pays positive tort damages in equilibrium.

Now suppose that the injurer observes $\bar{D}$, the average damage award paid out by other injurers to other injureds (for simplicity, assume that the expected level of actual harm is fixed across injureds). If the injurer observes $\bar{D}$ over multiple time periods, an increase might cause the injurer to update her beliefs about the expected level of harm. Suppose that the injurer updates her expectations such that $E[D|x]$ increases over every value of $x \geq x^*$. In this case, the higher expected tort damages lead to a fall in x. Correspondingly, this decrease in activity decreases the level of harm that the injurer imposes on the injured. In the case where the injurer is initially liable, that is if $x \geq x^*$, if the level of harm falls this will lead to lower expected liability payments in the tort system.

This simple model illustrates how an increase in jury verdicts could lead to lower expected liability in future periods by amplifying the deterrent effect of the tort system. The key assumption is that increases in $\bar{D}$ in prior periods cause injurers to update their expectations about the potential harm that they would have to pay out in their own cases. By increasing the expected penalty for committing harm, this leads to a reduction in the overall compensation in the liability system.

While theoretically sound, this argument places a heavy emphasis on the role of expected liability in driving safety precautions by potential injurers. In general, evidence of deterrence from civil liability is limited. For example, the evidence about whether the threat of medical malpractice liability leads to improved outcomes for patients is mixed (c.f., Currie & MacLeod, 2008; Kessler & McClellan, 1996, 2002; Lakdawalla & Seabury, 2012). From an empirical standpoint, the deterrence model might also be limited by the long lag associated with civil cases. In most cases, trials likely take too long for any changes in deterrence to develop over relatively short time periods (i.e., year-to-year).

2.2. Changes in settlement behavior

Absent a deterrent effect, past verdicts could also affect outcomes in current trials if changes in expectations altered the settlement behavior of litigants. That is, the previous section talked about how past trials changed the behavior of individuals prior to any harm being done or any dispute arising. In this section I outline how, taking the set of disputes as given, past verdicts can change

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[2] It is possible to alter the context of each model in certain ways that could produce similar predictions. For instance, under certain assumptions the predictions of the settlement model would hold if one were to focus on the decision to file a case or not. A more general way to think of the three models is factors that affect the set of disputes, factors that affect which disputes result in trial, and factors that causally drive outcomes for a given dispute at trial.

[3] See Miceli (1997) for a review of economic models of deterrence.