forthcoming, *International Review of Law and Economics*

**A Solution to the Problem of Nuisance Suits:**

**The Option to Have the Court Bar Settlement**

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**Abstract**

A solution to a broad category of nuisance suits is examined in this paper. The solution is to give defendants the option to have courts prevent settlements (by refusing to enforce them). Then, if a defendant knows he is facing a plaintiff who would not be willing to go to trial, the defendant would exercise his option to bar settlement, forcing the plaintiff to withdraw. And because the plaintiff would anticipate this, he would not bring his nuisance suit in the first place.

**JEL:** _D8, K41_

**Keywords:** Nuisance suits; Litigation; Uncertainty

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The authors thank Lucian Bebchuk, Daniel Klerman, Geoffrey Miller, Eric Rasmusen, Abraham Wickelgren, and an anonymous referee for comments, and Shavell thanks the John M. Olin Center for Law, Economics, and Business at Harvard Law School for research support.
1. Introduction

In this paper, we examine a solution to a broad category of nuisance suits. The solution is to give defendants the option to have courts prevent settlement, that is, to accord defendants the right to have courts declare that settlement agreements will not be enforced.

By a nuisance suit we refer to a legal action in which the plaintiff’s case is sufficiently weak that he would be unwilling to pursue it to trial. The type of nuisance suit that we consider arises in the following simple model of litigation.\(^1\) The plaintiff may choose to file a claim at a small cost. If the defendant does not settle with the plaintiff and does not, at a cost, defend himself, the plaintiff will prevail by default judgment. If the defendant does defend himself, the plaintiff may either withdraw or, at a cost, litigate.

Given this model, it is easy to see how nuisance suits occur. By filing a claim, even a plaintiff with a weak case places the defendant in a position where he will lose by default judgment unless he spends on defense. Hence, the defendant should be willing to pay a positive amount in settlement even to a plaintiff with a weak case – despite the defendant’s knowledge that were he to defend himself, a plaintiff with a weak case would withdraw. Plaintiffs with weak cases may take advantage of this situation and obtain settlements from defendants.

\(^1\) The authors developed this model in Rosenberg and Shavell (1985). For surveys of economic literature on nuisance suits, see Rasmusen (1998) and Spier (2005).
The solution that we consider to the foregoing problem of nuisance suits\(^2\) and extraction of settlements works in a straightforward way. If the defendant knows he is facing a plaintiff who would not be willing to go to trial, the defendant would want to exercise his option to have settlements rendered unenforceable. For if the defendant does this, the plaintiff would not be able to settle for a positive amount, and since the plaintiff would not be willing to go to trial, he would drop his case. Indeed, anticipating that the defendant would elect to prevent settlement, the plaintiff would not bring his nuisance suit in the first place. Thus, the option to bar settlement would cure the problem of nuisance suits under discussion.

As we also explain, the defendant would not exercise the option to bar settlement when he believes that the plaintiff is not bringing a nuisance suit and would be willing to proceed to trial. Therefore, the option to bar settlement would not turn out to stymie settlement when settlement would save the parties and the courts the costs of litigation. Another socially desirable aspect of the option to prevent settlement is that the court does not need any information about the litigants to implement it; the courts need merely accept requests of defendants to bar settlements.

In Section 2 below, we present an informal analysis of the model of nuisance suits and demonstrate how our solution would function to rectify it. In Section 3, we develop the analysis formally. In Section 4, we offer concluding remarks.

The solution to the nuisance suit problem considered here is similar to a solution to a problem concerning threats to bring injunctions examined in Ayres and Madison

\(^2\) Why the nuisance suits under consideration may constitute a social problem, and thus possibly warrant remedial policy, is noted in the concluding comments.
(1999), for they allow the threatened party to have the court effectively bar a settlement. More broadly, our paper illustrates the well-appreciated general conclusion that a party may benefit by removing future options, since this form of commitment can have advantageous incentive effects. (A stock example is that an advancing army might want to burn bridges behind it, so that its troops will fight aggressively and that the enemy will take heed of this.)

2. Informal Analysis

The diagram describing the model in the absence of an option to prevent settlement is shown in Figure 1 below.

![Figure 1: The Model Without The Option to Have The Court Bar Settlement](image)

3 In their model, a party may be threatened with an injunction (or similar action) when the purpose of the threat is to extract a higher settlement, not actually to exercise the injunction. If the threatened party can then have the court declare that, if granted, the injunction must be exercised (or made “inalienable”), that party might benefit.
First, the plaintiff P decides whether or not to file a claim and make a settlement demand; filing a claim involves a cost. Second, the defendant D decides among three choices: settle with P; default, in which event P is awarded the amount at stake; or defend, at a cost. Third, P decides whether to withdraw or to litigate. Last, if P litigates, he wins with a probability or loses with the complementary probability. The characteristics of the litigation situation—including the filing and the litigation costs, the amount at stake, and the likelihood of P prevailing at trial—are known by both P and D.

To understand the model, consider a numerical example. Suppose that the cost to P of filing is $25; that the cost to D of defense would be $200; that the cost to P of litigation would be $100; that the amount at stake is $1,000; and that the probability of P prevailing at trial is 1%.

Thus P’s case is weak and he would not litigate it: his expected judgment from litigation would be only 1% × $1000 or $10, which is less than his litigation costs of $100.

In order to see how nuisance suits arise, suppose that P files a claim and demands, say, $100 in settlement. D will reason that if he settles, his expenses will be $100, whereas if he does not settle, he will be led to spend $200 to induce the plaintiff to withdraw (D clearly will not default, for that would cost him $1,000). Hence, D will prefer to settle for $100 than not settle. Indeed, D would be better off settling for any amount up to his defense costs of $200 than not settling. The precise amount that P will be able to extract from D in a settlement depends on P’s bargaining power and, for

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4 In this figure, as is conventional, squares denote nodes at which a party makes a decision, and circles denote nodes at which chance determines the outcome.
concreteness, let us assume that P would be able to obtain $150.\textsuperscript{5} It follows that P would be willing to spend the $25 in filing costs in order to secure $150 in a settlement, for he would profit thereby; his profits would be $125. More generally, a nuisance suit would arise whenever the filing fee is less than the settlement amount that P could extract, and this amount could be as high as D’s defense costs (or the amount at stake, if this is less than the defense costs), no matter how weak P’s case.

Now consider the situation when defendants can have the court bar settlement. The model with this possibility is shown in Figure 2.

Note the differences from the model without the option to bar settlement. After P files a claim and makes a settlement demand, D can ask the court to bar settlement. (The court can bar settlement by declaring that it will not enforce any settlement agreement and that

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\textsuperscript{5} In the formal analysis of section 3, all the bargaining power rests with P (because he makes a single settlement demand – there are, for instance, no counteroffers), so he would be able to obtain a settlement of $200; but this is just for expository convenience.
this policy in the case is irrevocable. If D bars settlement, P can withdraw. If P does not withdraw, then D has only two choices (because settlement is barred): default; or defend, at a cost. If D defends, P can withdraw or litigate, at a cost. If there is litigation, P wins or loses.

Let us continue now with the numerical example. What we showed with reference to Figure 1 implies that, with reference to Figure 2, if D does not bar settlement, he will be led to settle for $150.

What if D elects to bar settlement? If P does not immediately withdraw, D will be led to spend $200 in defense (rather than default and lose $1,000), inducing P then to withdraw. Hence, P is indifferent between withdrawing immediately or withdrawing later, and we assume that P withdraws immediately. This means that D does not in fact spend $200 to defend himself.

It follows that D will choose to bar settlement: for if he does so, he induces P to withdraw and bears no costs; whereas if he does not bar settlement, he is led to settle for $150.

Because P can anticipate that D would elect to bar settlement and thus effectively deny P any return from filing, P will decide against spending $25 to file. In other words, P will refrain from bringing his nuisance suit.

Next, let us consider a situation in which P has a strong case and would be willing to proceed to trial. Suppose that P’s probability of prevailing is 60% (and otherwise,

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6 Note that the parties would not settle secretly: although they could do this, such a settlement would be valueless for the defendant, since the plaintiff could file suit despite the existence of the settlement.

7 In reality P would face positive costs were he not to withdraw immediately; he would have to submit to discovery, make himself present at hearings, respond to certain motions by D, and the like. Consequently, P would strictly prefer to withdraw immediately than to do so later.
assume as above), so that his expected return from litigation would be 60% × $1,000 or $600, exceeding his litigation costs of $100. Then we claim that D would not elect to prevent settlement and would settle with P.

In particular, let us examine the upper part of Figure 2, where D does not choose to bar settlement. In this branch, D would be willing to pay a settlement of up to $800. For D knows that if he does not settle, he would face two choices: default and lose $1,000; or defend, at a cost of $200, and then litigate and lose $600 on average. The latter route is what D would choose, and it would cost him $800 in total. Note that the reason D would litigate is that P would not withdraw, since as we observed P’s expected return of $600 outweighs his litigation cost of $100. The last point implies that P would be willing to settle for any amount over $500 (that is, $600 – $100), and bargaining power would determine where, between $500 and $800, the settlement would occur. Let us say the settlement amount would be $700 for concreteness.

Suppose instead that D opts to bar settlement, so the lower part of Figure 2 applies. Then P will not withdraw, D will defend, and D will spend $800 on average.

Faced with the choice between not barring settlement – and then settling for $700 – and barring settlement – and subsequently litigating and losing $800 on average – D will decide not to bar settlement, and settlement will occur. The implicit reason that D does not want to bar settlement is that, when P would be willing to litigate, D and P would really have to bear litigation costs if they do not settle.

To sum up, we have shown in a numerical example what we demonstrate generally below: defendants’ option to have the court prevent settlement will discourage nuisance suits from being brought; but it will not be problematic otherwise, as it will not
be exercised and will have no effect on the bringing or the settlement of strong suits, which would go to trial if not settled.

3. Formal Analysis

Let us assume that the plaintiff P and the defendant D are risk neutral and that the sequence of actions that they may choose is as was described in Figures 1 and 2 in the informal analysis. Define the following notation.

\[ f = \text{P's cost of filing a claim}; f \geq 0; \]

\[ s = \text{P's settlement demand}; s \geq 0; \]

\[ c_D = \text{D's cost of defense}; c_D \geq 0; \]

\[ c_P = \text{P's cost of litigation}; c_P \geq 0; \]

\[ p = \text{probability that P would prevail in litigation}; 0 \leq p \leq 1; \]

\[ w = \text{amount at stake (that P would obtain in a judgment)}; w > 0. \]

For simplicity, assume that \( c_D \) and \( c_P \) are each less than \( w \). Suppose that both parties know all these variables. We now determine the behavior of the parties, presuming that at each decision point the litigants assume that the future decisions of litigants are personally optimal.

We first consider situations where P would not be willing to litigate.

Proposition 1. Assume that the plaintiff P would be unwilling to litigate – his expected judgment \( pw \) is less than his litigation cost \( c_P \). Assume also that P’s filing cost \( f \) is less than the defendant D’s defense cost \( c_D \).

(a) In the absence of the opportunity to have the court bar settlement, P will bring a nuisance suit: P will file a suit and D will pay a positive settlement (of \( c_D \)) even though P would not be willing to litigate.
(b) In the presence of the opportunity to have the court bar settlement, P will not bring suit: were P to bring suit, D would opt to bar settlement, and P would withdraw, resulting in a loss to him of $f$.

Proof. (a) Working backwards in Figure 1 from the last decision node, observe that P would choose to withdraw, since $c_P > pw$.

Now consider D’s prior decision at the second decision node, among three alternatives. If he settles, he pays $s$. If he defaults, he pays $w$. If he defends, he spends $c_D$, and no more, since as just observed P would then withdraw. Hence, D will choose the action that results in the minimum of $c_D$, $w$, and $s$. Since $c_D < w$, it follows that D will settle if $s \leq c_D$ and otherwise will defend.

Next consider P’s initial decision. If he files a claim and demands $s$, this will be accepted by D if $s \leq c_D$, and otherwise D will defend and P will withdraw. Hence, if P files a claim, his optimal settlement demand is $s = c_D$, which will be accepted. Thus, P will obtain a positive net gain of $c_D - f > 0$. If on the other hand, P does not file a claim, his return is 0. Hence, he will file a claim, demand $c_D$, and this will be accepted.

(b) We now consider Figure 2 and work backwards from the last decision node. From what was just stated in the proof of (a), we know what happens in the upper part of Figure 2 following a decision of D not to bar settlement. Namely, D will settle if $s \leq c_D$ and otherwise will defend, in which case P will withdraw.

Consider next the part of the Figure following a decision of D to bar settlement. Working backwards from the last decision node, we know as above that P would withdraw rather than litigate. D’s decision prior to this node is between two alternatives, defaulting and losing $w$ or defending at a cost of $c_D < w$. Hence, D would defend and
spend $c_D$ and P would withdraw. The prior decision of P is whether or not to withdraw. If he withdraws, his cost (apart from the filing fee $f$) is 0, and if he does not withdraw, he will subsequently withdraw, so he would be indifferent between withdrawing and not. We assume that he does withdraw (see note 7 for a justification).

Next consider D’s decision whether or not to bar settlement. If D does not bar settlement, his cost will be the minimum of $s$ or $c_D$, whereas if he does bar settlement, his cost will be 0. Hence he will bar settlement (and strictly prefer this if $s$ and $c_D$ are positive).

Last consider P’s decision whether or not to bring suit. If he brings suit, since D will bar settlement, P will be led to withdraw, so P will suffer a cost of $f$, whereas if he does not bring suit, his cost is 0. Hence, P will not bring suit. Q.E.D.

We next consider situations where P would be willing to litigate. In order to simplify the exposition, we assume that $c_D + pw < w$, that is, D would not choose to default rather than litigate. 8

Proposition 2. Assume that the plaintiff P would be willing to litigate – his expected judgment $pw$ exceeds his litigation cost $c_P$. Assume also that P’s filing cost $f$ is less than the defendant D’s defense cost $c_D$ plus expected award $pw$.

(a) In the absence of the opportunity to have the court bar settlement, P will bring a suit and it will be settled (for $c_D + pw$).

(b) In the presence of the opportunity to have the court bar settlement, D will not elect that option and P and D will behave as if it does not exist; thus P will bring suit and it will be settled (for $c_D + pw$).

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8 Were we not to make this assumption, it would still be true that D would not want to bar settlement but the settlement amount would be $w$ (since this is what D would lose if he did not settle).
Proof. (a) Working backwards from the last decision node in Figure 1, observe that P would choose to litigate, since \( c_P < p_w \).

Next consider D’s prior decision. If he settles, he pays \( s \); if he defaults, he pays \( w \); and if he defends himself, he spends \( c_D \), and then litigates, so his expenses will be \( c_D + p_w \). Hence, D will choose the action that minimizes among \( c_D + p_w \), \( w \), and \( s \). It follows that D will settle if \( s < c_D + p_w \) (since the latter is less than \( w \)) and otherwise will defend and P will litigate.

Now consider P’s initial decision. If he files a claim and demands \( s \), this will be accepted by D if \( s < c_D + p_w \). If the settlement is not accepted, then since D will defend and P will litigate, P will obtain \( p_w - c_P \). Thus, P is best off setting \( s = c_D + p_w \) and receiving this in settlement. Since \( f < c_D + p_w \), P will prefer to file a claim than not.

(b) From what was just stated in the proof of (a), we know what happens in the upper part of Figure 2 following the decision where D does not bar settlement: D will settle if \( s < c_D + p_w \) and otherwise will defend, in which case P will litigate.

Consider the part of Figure following the decision where D bars settlement. Working backwards from the last decision node, we know that P would litigate. D’s decision prior to this is between two alternatives, defaulting and losing \( w \) or defending at a cost of \( c_D \) and then litigating, so incurring costs of \( c_D + p_w \). Hence, D would defend and incur costs of \( c_D + p_w \). The prior decision of P is whether or not to withdraw. If he withdraws, he would obtain nothing, and if he does not withdraw, he will subsequently litigate, so he would obtain \( p_w - c_P > 0 \). Hence, P would not withdraw; he would litigate.
Next consider D’s decision whether or not to bar settlement. If D does not bar settlement, his cost will be the minimum of $s$ or $c_D + pw$. If D bars settlement, his cost will be $c_D + pw$. Hence, we can assume he will not bar settlement (he will strictly prefer this if $s < c_D + pw$).

Last consider P’s decision whether or not to bring suit. If he brings suit, since D will not bar settlement, there will be a settlement if $s \leq c_D + pw$, whereas otherwise there will not be and P will litigate, obtaining $pw - c_P$. Hence, if P brings suit, he will choose $s = c_D + pw$ and there will be a settlement for this amount. Since $f < c_D + pw$, he will prefer to file than not to. Q.E.D.

4. Concluding Comments

(a) The source of nuisance suits studied in the model was the ability of the plaintiff cheaply to place the defendant in a position where he would lose unless he engaged in a relatively costly defense. Plaintiffs often seem able to do this. First, a plaintiff can usually file a claim at small expense. Second, it is not feasible for courts to exercise much scrutiny over the quality of claims or the basis of settlement, so that as a practical matter it is only the plainly frivolous claim that will usually be sanctioned. Third, if a claim is not challenged, the plaintiff will ordinarily prevail without further

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9 In Massachusetts, the filing fee for a civil suit in state court is $195. See Mass. Gen. L. c. 262, §§ 2 and 4C; Stat. 2003, c.26, §§ 468, 496, 500-501; Stat. 2004, c.352. In United States District Courts, the filing fee is $250. See 28 U.S.C. § 1914(a). Of course, attorney services for drawing up a complaint are also required.

10 A plaintiff can almost always adduce a facially plausible basis for a suit. This is probably why courts have been reluctant to impose sanctions against plaintiffs for filing pleadings that are not "warranted by existing law" or are not "likely to have evidentiary support after a reasonable opportunity for further investigation or discovery." Fed. R. Civ. P. 11. See Wright and Miller (2004), 5A, §1334. Moreover, some state courts do not award damages or attorneys’ fees to defendants unless they can show injury beyond the normal expenses attending defense of a lawsuit. See 52 Am. Jur. 2d (2000), Malicious Prosecution §§82, 83, 116.
judicial inquiry.\textsuperscript{11} Fourth, the defendant will often have to spend more to defeat a claim than the plaintiff’s cost of making it, for the defendant will have to gather and, at least, prepare to present evidence supporting his contention that he was not legally responsible for the harm done or that no harm was actually done.\textsuperscript{12} Also, it should be observed that the model is relevant in situations where plaintiffs and defendants have opposite roles to that studied above, namely, where defendants can assert counterclaims or defenses that have little or no merit but that plaintiffs would have to spend significantly to defeat.\textsuperscript{13}

(b) The nuisance suits considered in the model were implicitly assumed to be a problem for society (otherwise there would be no warrant for the policy allowing defendants to have the court bar settlement). That would be so if the costs of the suits – the litigation and settlement costs associated with them – outweigh the possible social

\textsuperscript{11} The Federal Rules of Civil Procedure require entry of judgment against a defaulting defendant by the clerk on complaints demanding a sum certain and by the court as a matter of course unless the judge finds it necessary to conduct a hearing to determine the amount of damages or resolve some other material question. See Fed. R. Civ. P. 55; see also Mass. Civ. Proc. Rule 55.

\textsuperscript{12} See, for example, \textit{Laurino v. Syringa General Hospital} 279 F.3d 750, 758 (9th Cir. 2000) (Kozinski, J., dissenting) ("urging sanctions beyond attorneys fees to deter plaintiffs from simply “paying a $150 filing fee ['and then sitting back']” on an unsubstantiated claim so that defendants must incur much more expense to have the claim dismissed, as exemplified by the present case, in which defendants were forced to spend over thirteen months in litigation and over $10,000 to obtain and support a dismissal order through multiple motions for reconsideration and appeal). See also Glater (2003). Concern about the problem of securities fraud “strike suits” prompted Congress to enact The Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 77z-1-78u-5(2000).

The defendant’s only relatively inexpensive means of defending himself is a motion to dismiss. See e.g. Fed.R. Civ. P. 12(b)(6). A reasonably skilled plaintiff will be able to draft a complaint that would survive such a motion, so that the defendant would have to turn to a summary judgment motion. See e.g. Fed. R. Civ. P. 56. For defendant to secure summary judgment, however, he must satisfy the demanding burden of showing that nothing in the plaintiff’s affidavits or other evidence raises a triable issue of material fact. See \textit{Wright, et al.} (1998)10A, §2712. To demonstrate conclusively that plaintiff has no case for trial, at least on the record, often entails considerable expense for defendants (for example, to marshal dispositive expert evidence that no harm was caused by pollution from its factory).

\textsuperscript{13} That is, we have in mind situations in which a counterclaim is not expensive for the defendant to make, and after it is filed, the plaintiff would have to spend more to defeat the counterclaim than it cost the defendant to make. In such situations plaintiffs would be led to lower their settlement demands by an amount commensurate with the cost of overcoming defendants’ counterclaims. The interpretation of our proposal in regard to such plaintiffs is that they would be allowed to request the court to bar settlement (or settlement on a particular issue of dispute).
benefits – notably, deterrence of undesirable behavior. If the claims of those bringing the suits are weak or fabricated, the social benefits of the suits would be slight or negative, suggesting that the suits are socially undesirable. However, it is possible to conceive of situations where that is not so, and nuisance suits are not socially undesirable.¹⁴

(c) The policy that we studied, of having courts refuse to enforce settlement agreements, is, as we noted above, simple for courts to implement, as it does not require them to obtain any information about the case.¹⁵ The policy should also be essentially costless to implement, because it is a policy under which the courts simply refrain from doing something. In contrast, other policies that could be employed to discourage nuisance suits, notably, imposition of penalties for such suits or use of fee-shifting, require courts to engage in inquiries about cases and legal costs, and thus would involve expense, perhaps substantial.¹⁶

(d) A different category of nuisance suit from that studied here is a suit that is brought only because the defendant does not realize the plaintiff would not litigate – a

¹⁴ Suppose that all suits are meritorious and would not be won because of problems of proof. Then it is possible that initiation of these suits would be desirable, since the settlements obtained by plaintiffs would create some measure of beneficial deterrence, despite the costs attending the litigation.

¹⁵ The policy is also one that courts sometimes employ. For example, courts deny enforcement of “Mary Carter” agreements. Under such an agreement, a plaintiff settles for a disproportionately low amount with one defendant in return for that party’s agreement to remain in the case and aid the plaintiff against non-settling defendants. See Benedict (1987). Another example is that courts bar settlements in which a victim of a crime would promise not to prosecute its perpetrator. A historical episode in which courts barred settlements of private prosecutions is given in Klerman (2001).

¹⁶ To impose penalties for nuisance suits, courts would have to determine whether a suit was, in fact, a nuisance suit, which would involve cost and could result in judicial error. To use fee-shifting to discourage nuisance suits would also require courts to determine whether suits are nuisance suits (or likely to be such); for otherwise courts would have to adopt fee shifting generally (which is not something that would necessarily be socially desirable). Furthermore, to employ fee-shifting, courts would have to assess reasonable fees.
suit in which the plaintiff masquerades as a party who would be willing to litigate. The policy we study here would not function to prevent these nuisance suits. The reason is that, if a defendant believes that a plaintiff is probably willing to litigate, then the defendant will want to settle, so will not bar settlement. The argument underlying this statement is essentially that which we used to show that when the defendant knows he is facing a strong suit that the plaintiff is willing to litigate, the defendant will not elect to have the court bar settlement.

17 Nuisance suits of this type are studied in Bebchuk (1988) and Katz (1990).
References


