Essay

Changing the Litigation Game: An *Ex Ante* Perspective on Contractualized Procedures

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I. Introduction

The practice of parties agreeing on the procedures that will govern the resolution of their dispute is an inherent characteristic of various private mechanisms for dispute resolution, such as arbitration and mediation. In these processes, not only do the parties set the procedures that will apply to their dispute, but they also choose their own judge, set out the rules of evidence, and agree on the substantive applicable law.[1] By having considerable freedom to fashion the way that their dispute will be resolved, contracting parties can realize benefits that enhance their welfare.

However, applying a similar idea of private parties designing procedural rules in public litigation seems intuitively problematic. The private–public tension that parties' procedural rulemaking creates raises normative questions about the contours of parties' autonomy within adjudication: Should parties be allowed to depart from publicly created rules of procedure designed to guarantee procedural justice and a fair, efficient resolution of disputes? Should there be any limits to their freedom in customizing procedures? What criteria should inform the enforcement of private agreements setting procedures in public courts?

These questions concern procedural agreements made at two different points in time: before and after the dispute arises. After the dispute arises and a claim is filed, litigants may agree on procedures that would govern in the course of litigation. These agreements are a product of the adversary model of litigation, which is characterized by litigants' control over the way their dispute is adjudicated.[2] Since the litigants, and not the court, can best

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1. *See e.g.*, Christopher R. Drahozal & Peter B. Rutledge, *Contract and Procedure*, 94 MARQ. L. REV. 1103, 1115–19 (2011) (empirically showing that contracting parties enter elaborate arbitration agreements).

2. *See, e.g.*, DAVID LUBAN, LAWYERS AND JUSTICE: AN ETHICAL STUDY 49–67 (1988); Lon L. Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 364 (1978) ("[T]he distinguishing characteristic of adjudication lies in the fact that it confers on the affected party a peculiar form of participation in the decision, that of presenting proofs and reasoned arguments for a decision in his favor."); Michael L. Moffitt, *Customized Litigation: The Case for Making Civil Procedure Negotiable*, 75 GEO. WASH. L. REV. 461, 479–81 (2007) (arguing that procedural contracts promote procedural justice values by enhancing party control over the process); Ellen E. Sward, *Values, Ideology, and the Evolution of the Adversary System*, 64 IND. L.J. 301, 302 (1989)

represent their interests, allowing them to agree on the procedures that will apply during trial can reduce their costs, lower their risks, and guarantee a fair outcome. Indeed, the Federal Rules of Civil Procedure give litigants wide latitude to agree on various procedures.[3] For example, they may enter stipulations,[4] consent to waiver of service of process,[5] amend pleadings,[6] waive the right to a jury trial,[7] and agree on the extent of discovery proceedings[8] or on the taking of depositions.[9]

Before the dispute arises, parties may enter pre-dispute agreements that set out procedures that will apply to the resolution of future disputes within public adjudication. These agreements, which are mostly made as part of a contract stipulating the parties' substantive rights and obligations, may include various procedural matters such as the statute of limitations, interim measures, trial by jury, the scope of discovery, and the rules of evidence.

The concept of agreements that set procedures in adjudication has only recently begun to attract academic attention.[10] Robert G. Bone's *Party Rulemaking: Making Procedural Rules Through Party Choice*[11] is an outstanding contribution to the scholarship that seeks to define the contours of parties' procedural freedom within public courts. Bone examines the arguments for and against party rulemaking and clarifies the difficulty in

("The adversary system is characterized by party control of the investigation and presentation of evidence and argument, and by a passive decisionmaker who merely listens to both sides and renders a decision based on what she has heard.").

3. *See, e.g.*, STEPHEN C. YEAZELL, CIVIL PROCEDURE 138 (7th ed. 2008) ("One of the hallmarks of the U.S. law is the extent to which the rules of procedure are 'default' rules, rules that govern if the parties have not agreed to something else.").

4. *See* 73 AM. JUR. 2D *Stipulations* § 15 (2012).

5. FED. R. CIV. P. 4(d).

6. FED. R. CIV. P. 15.

7. FED. R. CIV. P. 39.

8. FED. R. CIV. P. 29.

9. FED. R. CIV. P. 29(a).

10. *See, e.g.*, Sarah Rudolph Cole, *Managerial Litigants? The Overlooked Problem of Party Autonomy in Dispute Resolution*, 51 HASTINGS L.J. 1199 (2000); Kevin E. Davis & Helen Hershkoff, *Contracting for Procedure*, 53 WM. & MARY L. REV. 507 (2011); Jaime Dodge, *The Limits of Procedural Private Ordering*, 97 VA. L. REV. 723 (2011); Drahozal & Rutledge, *supra* note 1; Daphna Kapeliuk & Alon Klement, *Contracting Around* Twombly, 60 DEPAUL L. REV. 1 (2010); Moffitt, *supra* note 2; Henry S. Noyes, *If You (Re)Build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration's Image*, 30 HARV. J.L. & PUB. POL'Y 579 (2007); Judith Resnik, *Procedure as Contract*, 80 NOTRE DAME L. REV. 593 (2005); Robert J. Rhee, *Toward Procedural Optionality: Private Ordering of Public Adjudication*, 84 N.Y.U. L. REV. 514 (2009); Robert E. Scott & George E. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814 (2006); Jean R. Sternlight, *Mandatory Binding Arbitration and the Demise of the Seventh Amendment Right to a Jury Trial*, 16 OHIO ST. J. ON DISP. RESOL. 669 (2001); David H. Taylor & Sara M. Cliffe, *Civil Procedure by Contract: A Convoluted Confluence of Private Contract and Public Procedure in Need of Congressional Control*, 35 U. RICH. L. REV. 1085 (2002); Elizabeth Thornburg, *Designer Trials*, 2006 J. DISP. RESOL. 181.

11. Robert G. Bone, *Party Rulemaking: Making Procedural Rules Through Party Choice*, 90 TEXAS L. REV. 1329 (2012).

assessing its limits from both a utilitarian and a right-based perspective.[12] He then concludes that party rulemaking should be limited in three distinct situations: when parties mutually agree to exclude a third party whose legal rights might be affected; when the procedural agreement is one-sided; and when the agreement restricts private enforcement of substantive law or conflicts with a proper consideration of civil rights claims.[13] For other situations Bone suggests that if party autonomy in fashioning procedure is to be limited, it must be because it risks threatening the normative legitimacy of public adjudication.[14] Consequently, Bone identifies adjudication's core characteristic as its commitment to a distinctive method of reasoning. He explains that "because the reasoning process is central to adjudication, we should focus on those procedural rules that have a strong effect on how that process is conducted."[15] Thus, procedural agreements that imperil the "procedures that frame, guide, or incentivize this reasoning process" should not be enforced.[16]

This Essay, in response to *Party Rulemaking*, focuses on an important aspect that Bone's rigorous analysis tends to undermine—the divergence between pre-dispute (*ex ante*) and post-dispute (*ex post*) procedural agreements.[17] This focus is necessary in order to understand the different private and public implications of these agreements. In an earlier manuscript, *Contractualizing Procedure*,[18] we focused on the private implications of party rulemaking. We showed how the different timing of procedural agreements—*ex ante* or *ex post*—affects the various advantages that parties can gain. In this Essay we push our analysis further, by focusing on the public implications of party rulemaking.[19]

The Essay proceeds as follows: Part II defines the situations in which *ex ante* and *ex post* party rulemaking change the litigation game that procedural rules define. Our main observation is that any mutual commitment to constrain, extend, or substitute the set of permissible actions defined by a

12. *Id.* at 1380–84.

13. *Id.* at 1383–84, 1397–98.

14. *Id.* at 1378–80.

15. *Id.* at 1391.

16. *Id.* at 1337.

17. *Id.* at 1340–41 (arguing that the distinction between *ex ante* and *ex post* is not that sharp). For a critical analysis of an *ex ante* perspective of procedural rules, see generally Robert G. Bone, *Agreeing to Fair Process: The Problem with Contractarian Theories of Procedural Fairness*, 83 B.U. L. REV. 485 (2003) [hereinafter Bone, *Agreeing to Fair Process*].

18. Daphna Kapeliuk & Alon Klement, Contractualizing Procedure (Dec. 31, 2008) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id =1323056.

19. Just like in *Contractualizing Procedure*, *id.*, our analysis here concerns procedural agreements bargained for by sophisticated commercial parties who knowingly consented to modify procedures. We do not discuss procedural agreements made in the case of an imbalance of bargaining power, agreements that are unenforceable under contract law, agreements that impair third parties, or agreements that conflict with substantive law.

procedural rule modifies the procedural rule and hence the litigation game. Part III discusses the different private implications of *ex ante* and *ex post* modified procedures. We describe the benefits that parties can gain by agreeing to modify procedures *ex ante* as compared to *ex post*. Part IV analyzes the public implications of agreements that modify procedure. We suggest that the public costs and benefits of *ex ante* agreements should not be evaluated from an *ex post* perspective only but also from an *ex ante* perspective. Our main argument is that since litigation is only one of many possible contingencies that could have taken place once the parties agreed to modify procedure, the court should discount the public costs it observes, *ex post*, by the probability that these costs would materialize, *ex ante*. Part V examines how the analysis of modified procedures in public adjudication should be informed by the alternative of private arbitration. We argue that since adjudication and arbitration are private substitutes, and since adjudication of contractual disputes creates not only negative externalities but also positive public goods, the *relative* flexibility of modifying procedures in these two alternatives should be taken into account. Part VI concludes.

II. Changing the Litigation Game

Party Rulemaking makes an important distinction between *actions* and *rules*. It explains that "[t]he general procedural rules define the set of permissible actions, and lawyers for the parties choose actions from the permissible set."[20] Accordingly, general procedural rules are based on the premise of a *constrained choice* of actions by litigants; they may choose any action within the set of actions defined by the procedural rule, yet they are limited to choose only from this set.[21]

When referring to the choice of an action from the set of actions defined by the rule in the course of litigation, Bone makes an interesting analogy to a "game tree" in game theory. "Procedural rules create the rules of the litigation game. They identify those who can be parties to litigation (the players of the game), the stages at which choices can be made, and the actions available to each party at each stage."[22] He thus refers to what game theorists call an "extensive form game."[23] The order of moves in an

20. Bone, *supra* note 11, at 1338. Bone refers later to a possible choice among different sets of rules through choice of forum. *Id.* at 1338–39. But, as he writes, "[l]ike choice of action in the previous paragraph, however, choosing rules by choosing a forum does not place party choice in conflict with what the chosen court would otherwise have applied. It merely selects among different sets of official rules." *Id.*

21. Most rules also allow for no action.

22. Bone, *supra* note 11, at 1338 n.37.

23. *See, e.g.*, DOUGLAS G. BAIRD ET AL., GAME THEORY AND THE LAW 307 (1994) (defining an *extensive form game* as containing the following elements: (1) the *players* in the game; (2) when each player can take an action; (3) what choices are available to a player when that player can act; (4) what each player knows about actions the other player has taken when that player decides what

extensive form game is represented in a game tree. Each tree has nodes.[24] In each node a player has to choose from a set of actions—branches. At the end of each final branch there are terminal nodes, which set out the payoffs that the players receive.[25] Bone's characterization of a game tree relates to the assignment of the nodes and actions as the rules of procedure. In addition, procedural rules, such as burden of proof and fee shifting, also affect the payoffs to the litigants, in addition to substantive law.[26] These rules are not directed at the parties and therefore cannot be defined as part of their "set of actions"; yet they are obviously structuring the litigation and its outcomes. Finally, there are other rules which do not form part of the very abstract game form, such as rules that relate to the way the courts have to act and reason. These rules, too, impact the process and the outcome of litigation. Procedural rules, thus, define a *litigation game*.

Bone offers a typology of the various possibilities for the parties to make procedure.[27] Types I and IV are unilateral actions taken in the course of litigation.[28] Types II and III are procedures agreed upon before the dispute arises but also afterwards. *Party Rulemaking* focuses on the last two types. In Type II procedures, parties "commit in advance to the same actions they could choose strategically during litigation."[29] In Type III procedures, parties consent "to a general rule different from the official rule that would otherwise apply."[30] So, the distinction between Type II and Type III party-made procedures is based on whether the action could be taken during litigation (Type II) or not (Type III). For example, according to Bone, an agreement to lengthen the statute of limitations is a Type II agreement, while an agreement to shorten it is a Type III rulemaking.[31] He explains that an extension of the statute of limitations could be achieved noncooperatively through waiver, whereas a shorter period is not possible to achieve during litigation.[32]

Bone's typology, although appealing, does not take into account whether and how these choices affect the litigation game. According to Bone, a Type II rulemaking is a "simple rule"[33] which "does not alter the

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actions to take; and the *payoffs* to each player that result from each possible combination of actions); *see also id.* at 50–57 (analyzing the *extensive form game*). For a more formal definition of extensive form games, see DREW FUDENBERG & JEAN TIROLE, GAME THEORY 77–83 (1991).

24. BAIRD ET AL., *supra* note 23, at 311 (noting that a node is "the fundamental building block of the *extensive form game*").

25. *Id.* at 50.

26. Bone, *supra* note 11, at 1338 n.37 (noting that substantive and procedural law define litigation payoffs).

27. *Id.* at 1339–40.

28. *Id.* at 1339.

29. *Id.* at 1331, 1339–40.

30. *Id.* at 1332.

31. *Id.* at 1348.

32. *Id.*

33. *Id.* at 1338.

general rules that would otherwise apply; instead, it just moves to an earlier point in time a choice that the general rules allow parties to make later on."[34] However, the question should not be whether the chosen action is part of the original set of actions but whether the agreement *changes the set* of actions, thus imposing different constraints on parties' choice. Any such change alters the litigation game and consequently affects the range of possible contingencies that might emerge from it. It is when the litigation game changes that normative issues are at stake.

Moreover, Bone's typology undermines a key element necessary for assessing the limits of party autonomy to fashion procedure—whether the parties' choice is made before or after the dispute arises. As he writes: "Type II and Type III rulemaking can take place at any time before an action or rule is implemented. This includes during the course of litigation as well as before a lawsuit arises."[35] However, since any change in the litigation game changes the potential contingencies that could take place, the importance of the difference in timing of private rulemaking becomes apparent. When the change is made before the dispute, the range of contingencies that is affected is broader than when it is made after the dispute arises.

As we now show, both an agreement to commit to a particular permissible action within the original set and an agreement that allows for an action which is outside the set modify the otherwise applicable rule[36] and, thus, the litigation game. This change has strategic implications over the parties' behavior and over the outcome of the dispute. Moreover, these implications depend on the timing of the change made—before or after the dispute arises.

When the parties are engaged in litigation, they choose actions that best serve their interests. By selecting an action from the set defined by the procedural rule, a litigant also chooses *not* to take any of the other possible actions in the same set. Such choices are made unilaterally, as part of the strategic litigation game. For example, when a claimant waives her right to a jury trial[37] or decides to serve a limited number of interrogatories on the defendant,[38] or when a defendant waives service[39] or his statute of limitations defense,[40] they do not modify the procedural rule. They merely act according to the rule. In these cases the litigation game does not change.

When the parties agree on an action which is outside the set of actions that the rule defines, they modify the rule and, therefore, change the litigation

34. *Id.*
35. *Id.* at 1340.
36. Bone considers this possibility only in Type III rulemaking. *Id.*
37. FED. R. CIV. P. 38(d).
38. FED. R. CIV. P. 34 limits the number of interrogatories to twenty-five.
39. FED. R. CIV. P. 4(d).
40. FED. R. CIV. P. 8(c).

game. This is what Bone defines as Type III rulemaking.[41] However, an agreement to take a specific action which is part of the permissible set of actions according to the rule—a Type II rulemaking according to Bone—may also alter the rule. Such an agreement changes the set of actions that the rule defines and consequently the litigation game.

Contracting parties may modify procedural rules after the dispute arises, but also before it materializes—at the time of contracting. At the post-dispute stage, when the parties' agreement modifies the original set of permissible actions by restricting it to a subset of these actions (possibly only one of them) it changes the rule that would otherwise apply and, thus, modifies the litigation game. Likewise, when parties commit to an action which is outside the original set of actions, and therefore could not be taken otherwise, they modify the applicable rule. Once the modified procedure is agreed upon, the parties' strategic behavior changes, as each of them recognizes the new set of actions from which his opponent may choose. This situation is different from a unilateral choice of a specific action or a waiver of a possible objection to a specific action, which do not amount to a change of the general rule.

The following example clarifies the distinction between an *ex post* implementation of a procedural rule and an *ex post* change of a rule. Suppose that the rule provides that a claimant must bring suit no later than four years after the day the cause of action accrues and that the statute of limitations defense can be waived by the defendant. When the claimant brings suit after the prescribed period and the defendant waives his defense, the litigants do not modify the rule. They act according to the permissible set of actions that it defines. Thus, the litigation game is not altered. However, when the parties agree after the dispute arises to extend the statute of limitations, they modify the rule, by limiting the original set of possible actions available to the defendant. Since the claimant knows that if she brings suit the defendant *will not be able to object*, the modified procedure affects her decision whether to pursue litigation or to settle, and thus implicates the whole course of settlement negotiations and litigation between her and the defendant.[42]

Parties may also agree to expand the possible set of actions *ex ante*, ahead of the dispute. This would clearly amount to changing the applicable procedural rule. However, the rule would also change if they *commit ex ante* to take a particular action from the original set of actions defined by the rule or to avoid taking a specific action which could have been taken otherwise. According to Bone, this prior commitment is a simple rule which "does not alter the general rules that would otherwise apply; instead, it just moves to an earlier point in time a choice that the general rules allow parties to make later

41. Bone, *supra* note 11, at 1340.

42. Likewise, when the parties agree *ex post* to shorten the statute of limitation, they change the original set of permissible actions, and hence, they modify the rule.

on."[43] However, the parties' agreement to an action limits their future ability to choose other permissible actions from the original set. A prior commitment to a particular action from a set of available actions changes the original set of actions. As such, it necessarily modifies the litigation game.

For example, when the parties agree ahead of the dispute to forgo their Seventh Amendment right to trial by jury, to limit discovery, to limit the joinder of additional parties to a future claim, or to shorten or lengthen the statute of limitation,[44] they modify the otherwise applicable rule. From the parties' *ex ante* and *ex post* perspectives the only rule that will govern their dispute is the one that embodies their agreement. If their commitment did not amount to a modified rule, the parties would have no reason to commit to it ahead of the dispute. They would wait until the dispute arises and then choose any of the permissible actions within the original set.[45] Therefore, their pre-dispute commitment is an indication that the litigation game has changed.

To summarize, an *ex post* unilateral choice of action from a set of permissible actions is an implementation of the rule which does not change the litigation game. An *ex ante* or an *ex post* commitment to constrain, to extend, or to add to the original set of permissible actions defined by the rule modifies the rule, and thus changes the litigation game that would have taken place absent such commitment. Using Bone's typology, both Type II and Type III party rulemakings change the litigation game.

Having clarified when a procedural rule is modified, the next step in our analysis is to recognize that the same modified rules have different implications when they are agreed upon *ex ante*—before the dispute—than when they are agreed upon *ex post*—after it arises. Since commitments to modify procedure are made by private choice and since the parties' interests before the dispute are different than their interests after it arises, the same commitment must have different implications for the parties if it is made before the dispute than if it was made after it arises. Moreover, the range of potential future contingencies that the parties contemplate is fundamentally different, depending on the timing of the modification. These differences may not be observed in the specific case where the court is called upon to enforce the modified rule but only through an examination of the selection of

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43. Bone, *supra* note 11, at 1338.

44. Bone's analysis of these two commitments show how his criteria fail to distinguish between cases that change the litigation game and cases that do not. According to Bone, "[a]n agreement to lengthen the statute of limitations is a form of Type II rulemaking. The statute of limitations is a waivable defense, so the same result could be achieved noncooperatively by waiver after the plaintiff files." *Id.* at 1348 (footnote omitted). However, an agreement to shorten a statute of limitations is, according to Bone, a Type III rulemaking. *Id.* Our analysis shows that both agreements change the rule, as the otherwise permissible set of actions defined by the rule are not applicable after an agreement is made. In both cases the parties modified the procedure, and hence, modified the litigation game.

45. In fact, any changes of the rule that are expected to be implemented *ex post* will not be agreed to *ex ante*.

cases and procedures that was induced by the parties' private choice. Just as settlements induce selection of cases for trial,[46] so do modified rules. Such selection depends, among other factors, on the time of modification.

The distinction between an *ex ante* and an *ex post* agreement to modify a procedural rule is, therefore, crucial to the analysis of its implications. In the following Parts we compare the implications of *ex post* and *ex ante* modified rules from two perspectives: private and public.

III. The Distinction Between *Ex Post* and *Ex Ante* Modified Procedures: The Private Perspective

Contractualizing Procedure[47] focused on the different private implications of *ex post* and *ex ante* agreements modifying procedural rules.[48] The paper explained how the different timing of these agreements affects the range of benefits that parties can gain from them. The dividing point—the dispute—is significant because it changes the interest structure of the parties. As we showed, *ex post*, the litigants can achieve limited benefits from procedural cooperation, whereas *ex ante*, they can gain substantial advantages from modified rules both before and after the dispute emerges.[49] *Contractualizing Procedure* described three major advantages that contracting parties can achieve through *ex ante* modified rules and that cannot be obtained through *ex post* cooperation.

First, modified rules can reduce strategic and opportunistic behavior and litigation costs should a dispute arise.[50] It is often the case that during trial, litigants abuse various procedural mechanisms, such as discovery and provisional remedies, to impose excessive costs on their counterparts. The parties are locked in strategic Prisoner's Dilemma situations, where each litigant tries to gain advantage over her counterpart by not cooperating. Their failure to cooperate might therefore amount to a mutual loss. At the pre-dispute stage the parties hold incomplete information about their future position in the post-dispute stage.[51] They do not necessarily know who will

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46. George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984).

47. Kapeliuk & Klement, *supra* note 18.

48. Here too, the paper assumed that parties to a commercial contract consider altering procedural rules and then, knowingly and voluntarily, enter procedural agreements. We ruled out procedural arrangements that are unenforceable under contract law and ruled out all possible claims of mistake, misrepresentation, fraud, oppression, duress, undue influence, or some other claim of unconscionability.

49. The distinction between the effects of *ex post* and *ex ante* agreements was first presented by Steven Shavell. Steven Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J. LEGAL STUD. 1 (1995). It was then further developed by Bruce Hay. Bruce L. Hay, *Procedural Justice—Ex Ante vs. Ex Post*, 44 UCLA L. REV. 1803, 1803–04 (1997) (arguing for an *ex ante* approach for evaluating the fairness of alternative dispute resolution mechanisms).

50. Kapeliuk & Klement, *supra* note 18, at 16–19.

51. Hay, *supra* note 49, at 1828–39 (describing the difference between *ex ante* and *ex post* perspectives when information differs). *But see* Bone, *Agreeing to Fair Process*, *supra* note 17, at

assume the role of plaintiff and who will be the defendant should a dispute arise.[52] This state of *common* uncertainty enables the parties to modify procedures, to avoid abuse of process, and to save costs, as long as their agreement does not adversely affect their incentives to perform their contractual obligations and comply with substantive law. Additionally, since prior to the dispute the parties are eager to cooperate, they could modify procedural rules in exchange for payments transferred between them.[53]

Second, modified procedural rules can shape the parties' *ex ante* substantive and procedural behavior. On the substantive level, modified procedures may engender incentive effects on the parties' behavior in performing their contractual obligations and complying with substantive law. On the procedural level, *ex ante* modified procedures can affect the parties' decision to engage in a dispute, to bring suit, to invest in litigation, and to consider the possibility of a settlement.[54]

The third advantage concerns the parties' ability to increase their welfare by creating information revelation mechanisms. We showed how uninformed parties can make use of modified procedures to screen and sort among potential partners based on their private information about their propensity to perform their contractual obligations and about their future litigation behavior, such as their propensity to use the legal system should a dispute arise, and the likelihood of using procedural mechanisms to impose costs on their counterparts.[55]

Ex ante, the interests of the parties are aligned. They can realize a mutual joint surplus by agreeing to modified procedural rules that would best accommodate their specific circumstances should a dispute arise and a claim is filed. *Ex post*, the litigants are engaged in a strategic game and are mainly concerned about distributional issues. They will consent to a particular action from a set of permissible actions or to an action outside the set, to the extent that the agreement reduces their costs, lowers their risks, and does not adversely affect the expected outcome. However, when their interests are opposed, cooperation might be difficult to achieve. This situation can be described in game theory as a "zero-sum game." In this game the gain of one

526–29 (criticizing what he defines the "*ex ante* argument" as an argument that imposes "substantial restrictions on the parties' knowledge" and arguing that the assumptions underlying the argument are too strong).

52. For a criticism on this assumption, *see* Bone, *supra* note 11, at 1341 ("[T]he informational differences between *ex ante* and *ex post* are not as stark as some commentators assume.").

53. Kapeliuk & Klement, *supra* note 18, at 18. Bone argues that side payments are also possible during litigation; however, as he rightly acknowledges, "there is more room for making side payments *ex ante*." Bone, *supra* note 11, at 1341.

54. Kapeliuk & Klement, *supra* note 18, at 19–23.

55. *Id.* at 23–25. Another benefit explored by Scott and Triantis is the ability of parties to shift costs between the pre-dispute and the post-dispute stages. *See* Scott & Triantis, *supra* note 10.

player necessarily implies the loss of the other player.[56] Therefore, in situations where the choice benefits a litigant at the expense of the other, an agreement is unlikely.[57] Among the reasons for negotiation failure are rational[58] and behavioral[59] reasons. Most commonly, the only way to overcome such barriers is through an agreement on an overall settlement.

Bone claims that *Contractualizing Procedure* exaggerates the difference between the likelihood of cooperation *ex ante* and *ex post*.[60] Whether this is true or not is a matter for empirical examination. Yet, even if the difference is not that stark, this does not undermine the fundamental distinction between *ex ante* and *ex post* agreements to modify procedure, as far as the possible private benefits to be reaped from such agreements are concerned. *Contractualizing Procedure*'s main contribution was to highlight this distinction.

IV. The Distinction Between *Ex Post* and *Ex Ante* Modified Procedures: The Public Perspective

We now push the analysis one step further. We discuss how the *ex ante* perspective should affect the public—as distinguished from the private—analysis of costs and benefits of customized procedures. As we explain, an *ex ante* approach allows evaluation of public benefits and costs that are not manifested, *ex post*, in the case before the court. Furthermore, we show that the public costs of pre-dispute modified rules, however large they are, should be discounted by the probability that they would materialize. Such discounting is absent from scholarly literature analyzing *ex ante* procedural agreements,[61] including *Party Rulemaking*.

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56. *See, e.g.*, BAIRD ET AL., *supra* note 23, at 317 (defining a zero-sum game as "[a] game in which the increase in the *payoff* to one player from one combination of *strategies* being played relative to another is associated with a corresponding decrease in the *payoff* to the other").

57. *See* Kapeliuk & Klement, *supra* note 10 (analyzing this problem in the case of pleading standards).

58. Under the assumption of rationality, the main reason for negotiation failure is information asymmetry between the parties. *See, e.g.*, Lucian Arye Bebchuk, *Litigation and Settlement Under Imperfect Information*, 15 RAND J. ECON. 404 (1984).

59. These include reactive devaluation (negotiating parties discount the value of settlement offers only because they were made by their counterparts), endowment effects (negotiating parties find it difficult to forgo part of their perceived rights and value those rights more than if they did not perceive to own them), over-optimism (each party is overly optimistic about her trial prospects), and framing effects. *See generally* Daniel Kahneman & Amos Tversky, *Conflict Resolution: A Cognitive Perspective*, *in* BARRIERS TO CONFLICT RESOLUTION 45 (Kenneth J. Arrow et al. eds., 1995); Russell Korobkin, *Psychological Impediments to Mediation Success: Theory and Practice*, 21 OHIO ST. J. ON DISP. RESOL. 281 (2006).

60. Bone, *Agreeing to Fair Process*, *supra* note 17, at 491 (noting that "a procedure is fair if all parties would have agreed to the procedure had they been able to contract for it in advance of ("ex ante") their dispute").

61. For the literature on procedural rulemaking, *see* Kapeliuk & Klement, *supra* note 10.

In discussing these issues we define costs and benefits in broad, not necessarily economic, terms.[62] The costs are thus not only direct (opportunity costs of judiciary, jury, and administrative personnel, rent, and other resources) and indirect (such as congestion and delay costs imposed on third parties who wait for their turn to litigate and error costs), but also other, more abstract, costs. For example, an agreement that adversely impacts judicial legitimacy is considered as a public cost.[63] True, this broad perspective limits the possibility of conducting a comprehensive welfare analysis, as it is done by economists.[64] Absent a common denominator, how should one weigh, for example, adverse legitimacy effects against savings in litigation costs and improved contractual incentives? Still, this approach enables realization of what is at stake when analyzing the normative boundaries of parties' freedom to customize procedures.

A. The Public Implications of Procedural Modifications

Scholars considering the public implications of modified procedures focus on the *ex post* effects of these procedures. They examine how the enforcement of the parties' agreement would affect the direct and indirect costs of the judicial system as well as the court's legitimacy.[65] Bone's analysis of judicial legitimacy is no exception in this respect.

An *ex post* approach is appropriate if the enforcement of a post-dispute procedural agreement is at stake, and if such agreement could not be anticipated by the parties before the dispute. This is usually the case with *ex post* procedural modifications, in view of the conditions that must be satisfied for them to materialize, as explained in the previous Part.

However, this approach is problematic when examining a pre-dispute agreement to customize procedure, since it overlooks the broad effects of the parties' agreement, as they are evaluated from an *ex ante* perspective. Instead of analyzing how the parties' agreement has altered the litigation game, an *ex post* approach examines how one possible outcome has changed. Thus, an *ex post* approach mistakes one branch of the tree for the whole tree. For some customized procedures such omissions are inconsequential. However, often this would not be the case.

When evaluating the impact of a pre-dispute procedural commitment on institutional values such as judicial integrity and legitimacy, courts should be aware that the outcome they observe is only one of many possible contingencies that could have materialized. The modified rule has transformed the parties' relationship from the time they had agreed on it. It has affected their behavior in performing their contractual obligations, the

62. For Bone's analysis of the costs of party rulemaking, *see* Bone, *supra* note 11, at 1372–80.

63. *Id.* at 1378–80.

64. As Bone rightly suggests, *id.* at 1381.

65. Refer to Bone's detailed analysis, *id.* at 1374–80.

probability that a dispute would arise, and their litigation behavior. All these effects have public implications that go beyond the parties and that have to be considered when enforcement of the parties' agreement is at stake. Focusing on one contingency that has materialized misses the full range of public implications.

Suppose, initially, that an agreement modifying a procedural rule affects the direct and indirect costs of the judicial system but that it does not impact the court's institutional legitimacy. Suppose also that the modified rule increases the demand on the court's time and costs. For the purpose of clarification, we take an example of an agreement to allow broad discovery.[66]

When the parties opt for such an agreement after the dispute arises, and such an agreement could not be anticipated in advance, the only implications of the agreement may be those that are observable.[67] When considering whether to enforce the agreement, the court may find that the agreement increases the overall public direct and indirect costs, and therefore decline to enforce it.

However, an agreement made before the dispute arises involves conflicting effects on the overall costs of litigation, case backlog, and case delay. An increase of these costs in a specific case would also enhance litigants' incentives to settle and discourage their desire to litigate. Thus, a modified rule may increase the costs of a specific procedure but at the same time decrease the overall litigation costs since less cases would be filed. And of those filed, more cases would settle. The overall change in litigation costs would be the sum of these conflicting effects, which may be either positive or negative. A court focusing on the direct costs of broader discovery from an *ex post* perspective, would miss the pre-dispute agreement's potential for discouraging litigation and encouraging settlement, both effects reducing public litigation costs and delay.

Similar reasoning holds for broader institutional implications. Suppose that the criterion for evaluating the enforcement of a modified procedure is the one that Bone suggests: namely, that "the core element of adjudication is its distinctive mode of principled reasoning."[68] The effect of a pre-dispute agreement to modify procedure must then be evaluated by weighing its aggregate effect over this core element of adjudication. Aggregation must be conducted over all possible contingencies, viewed and weighted by their likelihood from an *ex ante* perspective.

Take, for example, a motion by the plaintiff for the discovery of electronically stored information against the objection of the defendant who,

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66. FED. R. CIV. P. 29.

67. If, prior to the dispute, the parties expect such agreement to take place, then this expectation would clearly affect their pre-dispute behavior. But then, the expected agreement is part of the litigation game, and it does not change it. For the analysis of procedural rules from an *ex ante* perspective, see Hay, *supra* note 49.

68. Bone, *supra* note 11, at 1390.

in turn, relies on a pre-dispute agreement not to make any such discovery in case of litigation. As we explained above, the agreement is a modified rule since it limits the otherwise available options that the rule defines.

The court may consider this motion on its specific merits and examine how the documents might affect the process and its outcome. It may find that absent such discovery the plaintiff would be unable to uncover certain facts, which are essential for a proper and accurate decision-making process. Given the central role of discovery in the Federal Rules of Civil Procedure,[69] the court may find this agreement to be detrimental to its ability to apply principled reasoning and to decide the case correctly, on its *true* merits.[70]

But the implications of this agreement over the court's ability to apply principled reasoning and reach an accurate decision may go way beyond the merits of the specific outcome in this specific case. The distinction between a pre-dispute and a post-dispute agreement is crucial here. Parties may make a pre-dispute agreement denying e-discovery for various reasons: to save costs, to induce each party to keep better record of future events, to limit opportunistic behavior in litigation, or to encourage early settlements. Any of these private goals has also public consequences. From an *ex ante* perspective this agreement combines possible contingencies that would be most conducive to a fair and reasoned adjudicative process, with the possibility of an eventuality in which the lack of e-discovery would critically affect the judicial process and its outcome. These types of contingencies are characteristic of a pre-dispute procedural agreement and are by and large absent when a similar agreement is made after the dispute arises.

Ex post, the litigants establish expectations about the possible outcome of the case and the contribution of discovered documents to the outcome. Both would therefore agree to limit discovery or forgo it altogether only if the effect on the expected outcome is not significant enough to overcome their joint savings in costs and delay. If the outcome is expected to be significantly affected by undiscovered documents, then one of the parties, at least, would refuse to forgo discovery. However, these conditions can hardly be anticipated before the dispute.

A court considering whether to enforce such an agreement should not find it very problematic to decide on the matter. First, the specific documents in the specific case are all that it should consider. There are no other "branches" of the litigation game that were affected as the agreement was made down the road after litigation embarked. Second, the court may presume that the documents are not indispensable for delivering a correct decision. Otherwise the litigants would have been unlikely to agree on it. In

69. 8 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 2001 (3d ed. 2010).

70. *But see* Bone, *supra* note 11, at 1391 ("[T]here is no way to identify particular procedures that strongly affect the reasoning process because all procedures have the capacity to do so . . . .").

fact, for this same reason, the court would be unlikely to be called upon to revoke such an agreement, as none of the litigants would so require.

The same modification, agreed to behind the "veil of incomplete information" before the dispute, has altogether different implications. By the time of the agreement the parties do not know which documents would be affected by such an agreement. They may contemplate future contingencies in which a document would be of prohibitive value in litigation. Nevertheless, in view of the private disadvantages of future e-discovery, they may still constrain it.[71] As a result, such contingencies might materialize, potentially leading to a significant divergence between the expected judicial outcome and the true merits of the case. Yet, just as the parties weigh possible future contingencies (including adverse ones) when contemplating a constraint on discovery, so should the court try to evaluate what were the public implications of such a constraint at the time of contracting.

Since this evaluation is done in retrospect, it is most difficult to implement for reasons we explicate below. Therefore, one cannot realistically advocate a fully blown cost–benefit analysis (those terms broadly defined) of the discovery constraint. Still, in view of the potential positive implications of such a constraint, including inducement of better process and outcome in many contingencies, a court may be more likely to tolerate a specific divergent outcome. Evaluating it against the full spectrum of possible contingencies, viewed before the dispute, should prove different than narrowly focusing on its direct and specific implications for the case before the court.

True, when the negative value attributed to a particular modified rule is high, it may be sufficient to render it unenforceable, irrespective of the likelihood of litigation taking place. For example, a modified rule that directly regulates the conduct and the decision-making process of the court might carry such a red flag over it that courts cannot tolerate enforcing it, rare as its realization might be.[72] This may be true independent of the modified rule's potential private and public merits, as they are viewed from a pre-dispute perspective.

However, there is a broad selection of modified procedures, which might impact the process and outcome of adjudication, even though these procedures are directed at the parties and not at the court. When considering whether to enforce any such modified rule *ex post* the court ought to understand the modification's broad implications, not only the effects in the specific case before it. What might seem problematic in a specific case

71. For the benefits that contracting parties can gain from such agreement, see Kapeliuk & Klement, *supra* note 18, at 16–23.

72. Bone considers these rules as "rules defining the decision-making body and the decision protocol, including not only those directed to the judge but also to the jury." Bone, *supra* note 11, at 1393.

might prove valuable, based on the same normative criterion, if viewed from an *ex ante* perspective.

We do not make here any claim as to what should be the criterion for deciding which procedural modifications are to be enforced. Nor do we examine which virtues are fundamental to the legitimacy of adjudication so that interfering with them should not be tolerated. Rather, we highlight the significance of the *timing* of modification for the analysis of the modification's public implications. An examination of a modified rule, without reference to whether it was agreed before or after the dispute, risks missing its potential implications, positive and negative, from a public perspective.

B. The Inherent Difficulties of Analyzing Public Ex Ante *Costs and Benefits in Retrospect*

As Bone rightly explains, it is difficult for courts to analyze, *ex post*, the overall costs and benefits of pre-dispute procedural modifications.[73] This is true even if the analysis is restricted to purely economic costs and benefits. Broadening the perspective to the institutional legitimacy of the judicial system further complicates such analysis.

There are various reasons for this difficulty. First, courts observe *ex post* only one possibility which has materialized out of many potential contingencies. They are called to decide a specific dispute which has turned into a specific litigation following a specific course of action by the litigants. Courts do not see all other possibilities which did not come true either by chance or because of a deliberate decision by the parties. All contingencies where the parties have satisfied their contractual obligations, or have decided not to embark on litigation even if those obligations were not satisfied, are not considered *ex post*. *Ex post*, courts can only speculate, absent any concrete evidence, what these other possibilities would have been. Hence, analyzing their consequential costs and benefits is problematic.

Second, courts would find it very hard to identify and measure all the pre-dispute benefits induced by a modified procedure. We described above the conflicting implications of any change in litigation costs over total costs and delay. Consideration of other advantages of modified procedures such as improvements in incentives to perform contractual obligations—and, consequently, over the total value of a contract—and information revelation benefits, induced by the choice of a specific procedure, is even more complicated.

Do these difficulties imply that courts should only examine the *ex post* effects of a modified procedural rule and ignore all other potential contingencies, consequently ignoring the timing of modification? We believe not. Pre-dispute analysis is indeed difficult to conduct in retrospect.

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73. *Id.* at 1381 (describing it as "impractical").

Yet, focusing only on observable *ex post* costs and benefits would be overly restrictive and inadequate. Just as substantive contract law focuses on the time of contracting, so should procedural contracts be analyzed from the same perspective.[74]

We are, therefore, aware of the potential problems in analyzing modified procedures from an *ex ante* perspective. Although this is unfortunate, we are unable, at this stage, to provide any easy way out of these problems. We only suggest that courts be aware of these complications and, in particular, that they take heed of the timing of the agreement to modify a procedure when considering its public implications.

V. The Arbitration Alternative

Parties may agree to modify procedural rules both before and after the dispute arises. Yet, their choice is not limited to the specific rules that will govern the adjudication of their dispute but also to the forum that will rule on its merits. While public courts are the default forum for the resolution of disputes, parties may agree to opt for a private forum to settle their controversies. They may do so at the contracting stage or after the dispute arises.

Whether the parties opt for public adjudication or for private arbitration, they may wish to customize the procedure that will govern their dispute so as to best serve their interests. When choosing arbitration, they have almost unrestricted freedom to fashion the procedure. In contrast, when opting for public adjudication, their choices might be subject to court approval. This difference may affect the parties' choice between arbitration and adjudication.

In the previous Part we argued that the analysis of the public implications of procedural agreements should focus not only on their *ex post* public costs and benefits but also on their *ex ante* public effects. Our main claim was that since litigation is only one of many possible contingencies that could have taken place once the parties entered their agreement, a court should discount the public costs it observes, *ex post*, by the probability that they would materialize, *ex ante*. We acknowledged, however, that an evaluation of the public costs and of the probability of their occurrence is difficult to implement in retrospect as courts do not necessarily possess the necessary tools to quantify them. This obvious difficulty[75] leaves us with the

74. As Bone rightly suggests, "there is an alternative to case-specific evaluation with all its prediction problems. The formal rulemaking process can be used to create general rules regulating party rulemaking." *Id.* at 1384. However, this framework would possibly prove too general, since the value and costs of pre-dispute modified procedures would often depend on the specific context in which they were modified.

75. Or, as Bone suggests, impracticability. *Id.* at 1381 ("A judge in an individual case lacks the information and expertise to make highly complex predictions about case-specific benefits and costs.").

question of whether courts should, as a result, deny the enforcement of procedural arrangements and thereby encourage parties who wish to customize procedure to opt for private arbitration. In order to address this question we return to the concept of externalities.

As we explained,[76] litigation creates various types of positive and negative externalities—public costs and benefits—that are not considered by the parties when they commit to modify procedures. Thus, there is a divergence between the private and public interests, both concerning the mere desirability of adjudication[77] and the desirability of enforcing specific modified procedures. It is the negative externalities, and the resulting misalignment of the public and private interests, which render specific modifications suspect and justify *ex post* judicial intervention.

In contrast, contracting parties who opt for arbitration internalize all costs and benefits of their future dispute should it arise, including those of the arbitration mechanism itself. Hence, if contracting parties adopt a certain procedure for their future disputes it must be efficient, in that its overall costs are lower than its overall benefits.

Bone rightly criticizes what he calls "[t]he flawed argument from arbitration."[78] His main point is that one cannot make a simple comparison between adjudication and arbitration since they perform different functions and draw on different sources for their legitimacy.[79] In our terminology, adjudication creates externalities which are absent in arbitration. This distinction between the two processes implies that one may not derive normative conclusions about modified procedures in adjudication from observing similar procedures in arbitration.[80] Bone is also right in arguing that the mere flight from adjudication to arbitration is not, by itself, a justification to render adjudication more flexible.[81]

We argue that whether substitution of arbitration for litigation is problematic depends on the net value of externalities, positive and negative, created by adjudication. If this net value is negative, then all contractual disputes should be resolved in arbitration. Since parties internalize all costs and benefits in private arbitration, their agreement to arbitrate must necessarily be efficient. Thus, by having all contractual disputes decided by arbitration, one can guarantee efficiency, narrowly defined.[82]

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76. *See supra* Part IV.

77. *See generally* Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997).

78. Bone, *supra* note 11, at 1354.

79. *Id.*

80. *Id.*

81. *Id.* at 1354–55.

82. *See* Bruce L. Hay et al., *Litigating BP's Contribution Claims in Publicly Subsidized Courts: Should Contracting Parties Pay Their Own Way?*, 64 VAND. L. REV. 1919, 1948–50 (2011) (suggesting the imposition of a user fee on commercial contractual litigation to internalize all its costs and induce an efficient choice between litigation and arbitration).

However, one must also bear in mind that litigation does not produce only negative externalities but also positive public goods[83] such as legal precedents and deterrence effects,[84] as well as public substantiation of its institutional legitimacy.[85] When parties agree to modify procedural rules within adjudication they do not internalize the negative externalities that their agreement produces. But they do not internalize the public benefits of adjudication either. If one is to maintain litigation of contractual disputes, at least for adjudication's positive externalities, one cannot dismiss the substitution effect between the two institutions out of hand.

When the choice of process is made after the dispute arises, the parties are locked into litigation as the default procedure. Thus, constraining the parties' ability to modify procedures is unlikely to induce them to agree to opt out of it. But, when the choice is made before the dispute arises, rendering litigation less flexible would drive more parties to opt out of it. Since this choice has public implications, they must be taken into account when considering the flexibility that contracting parties are allowed in structuring future procedures within public adjudication.

VI. Conclusion

This Essay argued that timing matters. It matters with respect to the point in time in which parties agree to modify procedure, which, in turn, affects the private and public implications of modified procedures. *Party Rulemaking* is an important contribution to the emerging scholarship on modified procedures. Bone's identification of the core of adjudication's normative legitimacy—its distinctive mode of reasoning—as the threshold for enforcing modified procedures is without doubt an important step in delineating the limits of party choice in customizing procedures. Yet, his focus on *ex post* public implications is too narrow.

Our main argument was that an *ex post* perspective on the public implications of modified procedures is appropriate when parties agree to modify procedures after the dispute arises. However, an *ex post* approach to the public implications of *ex ante* modified procedures misses an important factor—the fact that the outcome that the court observes is only one of many possible contingencies that could have materialized once the parties agreed to a modified procedure. The modified procedure affected the parties' behavior in performing their contractual obligation, the probability that a dispute

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83. A public good has two related characteristics: its consumption by one person does not leave less for others, and it is nonexclusive, meaning that once the good is produced, no one can be denied of its consumption, even if they have not paid for it. *See, e.g.*, ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 42 (3d ed. 2000).

84. For the analysis of the private and public goods provided by adjudication, see William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235 (1979); Moffitt, *supra* note 2, at 519 ("Courts perform important functions in society beyond dispute resolution. Courts articulate community norms.").

85. Moffitt, *supra* note 2, at 519.

would arise, and their propensity to litigate or settle. These effects are not limited to the private domain but have also public implications, which should be considered when the normative question is at stake. An *ex post* approach, which focuses only on the contingency that has materialized, ignores the full range of public implications of the modified procedure. Thus, an appropriate approach should discount the public costs of such procedure by the probability that they would materialize. We acknowledge that a quantification of the *ex ante* public effects of modified procedures is difficult. Yet, we maintain that this difficulty cannot justify disregarding these effects.