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US class actions: Promise and reality

Christopher Hodges



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## **US CLASS ACTIONS: PROMISE AND REALITY**

Christopher Hodges

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## **European Regulatory Private Law: The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation (ERPL)**

A 60 month European Research Council grant has been awarded to Prof. Hans-Wolfgang Micklitz for the project “European Regulatory Private Law: the Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation” (ERPL).

The focus of the socio-legal project lies in the search for a normative model which could shape a self-sufficient European private legal order in its interaction with national private law systems. The project aims at a new-orientation of the structures and methods of European private law based on its transformation from autonomy to functionalism in competition and regulation. It suggests the emergence of a self-sufficient European private law, composed of three different layers (1) the sectorial substance of ERPL, (2) the general principles – provisionally termed competitive contract law – and (3) common principles of civil law. It elaborates on the interaction between ERPL and national private law systems around four normative models: (1) intrusion and substitution, (2) conflict and resistance, (3) hybridisation and (4) convergence. It analyses the new order of values, enshrined in the concept of access justice (*Zugangsgerechtigkeit*).

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## **Abstract**

The US class action is the best-known tool of civil procedure for enforcement of mass private rights. It is intended to achieve judicial and procedural economy in civil procedure, and to exert significant pressure on corporate defendants to observe the law. This piece summarises the major empirical evidence on how the mechanism works. It confirms extensive enforcement of law. It also identifies issues of selectivity of case types (especially securities cases brought by investors), high transactional costs and reductions in sums received by claimants, the risk that high economic factors distort the legal merits of settlements, the limited evidence on evaluating the legal merits of outcomes, forum shopping, and aspects of conflicts of interest that have been criticised by European politicians as abusive. The piece notes that these features are predictable consequences of the policy of encouraging widespread private enforcement of law by incentivising intermediaries and reducing risk to claimants. Various questions are noted in relation to the future of collective redress in the different context of the European legal order.

## **Keywords**

Class action, MDL, deterrence, empirical evidence, costs, merits, outcomes, evaluation

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## **Introduction\***

The traditional collective action narrative argues that aggregating individual claims *should* produce 'judicial economy', or at least procedural economy, by sharing overall cost across multiple claims, thereby lowering the cost of individual cases, and thus increasing access to justice. It is also argued that aggregation gives the claimant side a lot of power, especially where the defendant cannot recover costs (as often in USA, and under the old position in England under legal aid). In analysing the extent to which those points apply in aggregate mechanisms for civil claims, it is important to differentiate between different models, since the effect of the different funding mechanisms and rules on cost shifting produce entirely different situations. Indeed, strong European political statements have criticised the American class action model.

In analysing the US class action model and the emerging European collective action model, wider questions have been raised, to which answers are not readily available. First, the empirical evidence shows now that *any* class action will have problems, notably selectivity in the types of case that are pursued (with some cases not being taken at all by intermediaries), high cost, and poor repayment of claimants. Delay is a problem in the EU but not USA. Second, these features are largely produced in USA because the system loads the mechanisms so as to assist claimants. To European eyes, that policy produces major conflicts of interest for the intermediaries, and potential for abuse. On the other hand, where the EU models introduce safeguards against abuse, the mechanism becomes unattractive to intermediaries and funders.

This chapter will examine the empirical evidence on US class actions. It will first set out the ideal: the intended benefits of aggregating similar individual claims. These are facilitating procedural economy, increasing access to justice, and providing deterrence against law-breaking. There follows a summary of the most significant empirical research into a number of aspects of how class actions operate in practice, from which it will be noted that reality falls somewhat short of the ideal. The main subjects addressed are: selectivity of types of case, and the reasons for that; particular evidence on major case types, notably securities cases; transactional costs; reduction in damages paid to claimants, especially in consumer cases; the difficulty of identifying the extent to which cases and settlements have merit; forum shopping; and how the financial incentives generate conflicts of interest and abuse. It is then noted that various important shifts that have occurred in US class action practice, moving cases firstly away from individual court proceedings towards multi-district management, which has produced effects on settlement, and secondly in consumer cases away from litigation entirely towards contractual arbitration. The chapter ends by drawing general conclusions, both on the US class action system and general implications for Europe and elsewhere.

## **The objectives of aggregation of claims**

This section reviews the objectives of civil procedure mechanisms that aggregate individual claims into a single procedure, usually known by its American name of a class action. In Europe from around 2010 the term collective action has emerged in order to distinguish the EU model from the American class action.

There are two primary objectives of aggregating individual civil claims into a single coordinated procedure: to achieve procedural economy, and thereby to increase access to justice.<sup>1</sup> Both these goals

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are simple to grasp. It should be more efficient to process a single procedure than many similar claims. The concept is sometimes referred to as one of facilitating judicial economy in achieving efficient case management. There may also be economies of scale in relation to the transactional costs of claimants and defendants.<sup>2</sup> That incremental cost reduction might also facilitate an incremental increase in the number of cases that are economic for claimants to bring, thereby achieving the second goal of increasing access to justice. That second goal is particularly relevant in facilitating individual claims that are small in value, so that they become viable and relevant rights are vindicated and not flaunted. This goal recognizes the fact of cost-effectiveness, in that some claims are too small to be worth processing given the cost of using the court system. It is well established that consumer claims are generally individually of very low value.<sup>3</sup>

These objectives are somewhat changed by what occurs in practice. In the USA, it is well established that the requirement for court certification of a class action provides a major hurdle, but if a class is certified then the chances of settlement are very high.<sup>4</sup> The settlement of cases, as opposed to judicial determination, provides economies for the court and the parties. So the reality is that judicial economy is irrelevant, and the true objective is *procedural* or *process* economy. Indeed, despite the impression that mass litigation is extensive in the USA, such claims appear to constitute a small part of the judicial administrative workload, time being spent on certification and settlement hearings.<sup>5</sup>

A third objective applies under the American model, namely deterrence, on the theory that imposing internalisation of the cost of undesirable external costs created by a business, or the imposition of additional punitive damages, will deter future breaches of the law. The deterrence objective appears in some European writing and policy statements (on competition law and sometimes financial services) but less frequently in some areas than its ubiquitous appearance in US literature. The extent to which evidence supports the theory that private enforcement, or public enforcement, in fact deters corporate behaviour has been questioned<sup>6</sup> and this extensive topic is not discussed further here. However, it is important to highlight an important structural difference that American reliance on deterrence leads to in contrast with European structures, which now follows.

(Contd.) \_\_\_\_\_

<sup>1</sup> CJS Hodges, 'Collective Actions' in P Cane and HM Kritzer (eds), *The Oxford Handbook of Empirical Legal Studies* (Oxford, Oxford University Press, 2010).

<sup>2</sup> RG Bone, 'Class Action' in CW Sanchirico (ed), *Procedural Law and Economics* (Cheltenham, Edward Elgar, 2012).

<sup>3</sup> C Hodges, 'Consumer Redress: Ideology and Empiricism' in K Purnhagen and P Rott (eds), *Varieties of European Economic Law and Regulation. Festschrift for Hans Micklitz*, (Springer, 2014); *Special Eurobarometer 342. Consumer empowerment* (European Commission, 2011).

<sup>4</sup> Garth's study of all federal class actions in the Northern District of California certified between 1979 and 1984, plus interviews covering an additional 73 cases not certified, found that after certification, the settlement value of a plaintiff's class action shifts dramatically in the plaintiff's favour. Out of 73 *uncertified* class action, 32 dismissals and 19 summary judgments for Ds, but only 11 settlements and a mere 4 summary judgements for Ps (one unascertainable). None of the 73 were litigated. By comparison, of the 46 *certified* class action clusters, 36 were settled and 10 litigated. Most certification battles were over 'adequacy' or 'typicality' of the named plaintiffs. B Garth, IH Nagel and SJ Plager, 'The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation' (1987-88) 61 *Southern California Law Review* 353.

<sup>5</sup> Damage class actions constituted at most only 2.7% of all civil cases filed in all federal courts from 1972 to 1977: R Bernstein, 'Judicial Economy and Class Actions' (1978) 7(2) *The Journal of Legal Studies* 349-370. In California between 2000 and 2006, class actions were less than one-half of one percent of all civil litigation: H Heiman, *Findings of the Study of California Class Action Litigation, 2000-2006* (Judicial Council of California, Administrative Office of the Courts, 2009).

<sup>6</sup> CJS Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Compliance and Ethics* (Oxford, Hart, 2015).

## The US model

The encouragement of private enforcement is a particular feature of the USA's legal system.<sup>7</sup> Class actions are a deeply political weapon and activity within the system of American democracy and separation of powers.<sup>8</sup> The political ideology is to empower individual citizens to exercise their personal freedom to exert their rights. That model is held to maximise adherence to the law by maximising the number of enforcement agents within the population, and is said to avoid disadvantages of enforcement by public agencies, such as capture<sup>9</sup> and limited resources.<sup>10</sup>

The above account contains one major assumption, namely that individual citizens can assert right by themselves. That assumption appears to be illusory. The reality is that the enforcement of law is overwhelmingly only achieved where intermediaries are involved.<sup>11</sup> Thus, public enforcement requires officials, and private enforcement typically requires lawyers, and funders. The class action encourages private lawyers to be intermediaries, and to perform the dual roles of litigation funder and professional representative, by providing a series of economic incentives. This model can be contrasted with the emerging European model where ombudsmen or other ADR entities and public regulatory agencies function as intermediaries, increasingly funded by business. In the US litigation system, lawyers acting as 'private attorneys general'<sup>12</sup> investigate and challenge potential wrongdoing and negotiate the imposition of deterrent penalties under the authority of the court system.<sup>13</sup>

In accordance with this model, the system includes an absence of barriers to investigation, and incentives to litigate and to succeed in settlements. First, access to evidence is through wide powers of discovery, deposition of witnesses of fact and interrogatories. Second, there are liberal rules on pleading allegations (notice pleading) and on liability. Third, the financial incentives are: no requirement on plaintiffs to fund a case; funding by lawyers, which may be on a contingency (no win no fee) arrangement and on a percentage of the recovery; funding in class actions typically being awarded by the court based on a percentage of the damages; no risk to a plaintiff of having to pay costs in the event of failure (i.e. no cost shifting); requirements on defendants to pay costs under many statutes;<sup>14</sup> levels of damages that are intended to provide deterrence and to cover plaintiffs' healthcare

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<sup>7</sup> C Hodges, 'Objectives, Mechanisms and Policy Choices in Collective Enforcement and Redress' in J Steele and W van Boom (eds), *Mass Justice* (Edward Elgar, 2011).

<sup>8</sup> BG Garth, 'Power and Legal Artifice: The Federal Class Action' 26 *Law & Society Review*, (1992) 237 ('The class action is a politically empowering legal artifice'); RA Kagan, *Adversarial Legalism: The American Way of Law* (Boston, Harvard University Press, 2001); W Haltom, M McCann, *Distorting the Law: Politics, Media, and The Litigation Crisis* (University of Chicago Press, 2004); WV McIntosh and CL Cates, *Multi-Party Litigation: The Strategic Context* (Vancouver, UBC Press, 2009).

<sup>9</sup> S Farhang 'Public Regulation and Private Lawsuits in the American Separation of Powers System' (2008) 52 *American Journal of Political Science* 821.

<sup>10</sup> See eg EA Bardach and RA Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness* (Philadelphia PA, Temple University Press, 1982); J-J Laffont and J Tirole, 'The Politics of Government Decision-Making: A Theory of Regulatory Capture' (1991) 106(4) *Quarterly Journal of Economics* 1089.

<sup>11</sup> Much of the European debate can be viewed as revolving around whether intermediaries should be private lawyers, consumer associations, public regulators, private ADR entities, or quasi-public ombudsmen.

<sup>12</sup> SN Subrin and MYK Woo, *Litigating in America* (New York, Aspen Publishers, 2006).

<sup>13</sup> S Shavell, *Economic Analysis of Accident Law* (Cambridge MA, Harvard University Press, 1987), 277-86 (comparing and contrasting *ex ante* vs. *ex post*, and privately initiated vs. state initiated approaches to risk regulation); S Issacharoff, 'Regulating after the Fact' (2007) 56 *DePaul LR* 375, 377 ('What really sets the United States apart is the fact that its basic regulatory model is *ex post* rather than *ex ante* . . .'); D Rosenberg, 'The Causal Connection in Mass Exposure Cases: A 'Public Law' Vision of the Tort System' (1984) 97 *Harvard LR* 849, 853 ('Society has for the most part relied on the tort system both to prevent mass exposure accidents and to compensate their victims.' and identifying five advantages of the tort system 'over the conventional administrative process').

<sup>14</sup> See S Farhang, *The Litigation State. Public Regulation and Private Lawsuits in the U.S* (Princeton NJ, Princeton University Press, 2010).

costs; the potential for punitive or triple damages; and the ability to exert significant bargaining power through assembling mass claims. Fourth, there may be elements of public sanctioning: decisions on liability and penalties being made by juries, and the possibility of punitive damages.

Each US State has its own rule on class actions. At Federal level the rule is Rule 23 of the Federal Rules of Civil Procedure. These rules all differ in some respects: such details are unnecessary for the purposes of the current analysis.

The Federal Rule provides the following main types of class actions:

- Injunctive and declaratory relief (Rule 23(b)(2) and Rule 23(b)(1)(A)). Civil rights cases and other cases seeking institutional change, discrimination, pollution.
- Monetary compensation (Rule 23(b)(3) and Rule 23(b)(1)(B)). This covers:
  - Mass torts. Products, transport crashes, building collapses, oil spills.
  - Securities and shareholders.
  - Other financial injury, often aiming at restitution of illegal gains, e.g. employment, antitrust, and consumer cases (involving a wide range of legal theories).

The US class action model is the opt out procedure: a single representative plaintiff brings a case that is deemed to be sufficiently similar to a class of others such that determination of the exemplar can and will determine and bind all the rest – unless any individual(s) in the class opt out and prefer not to bring their case(s) or to proceed with an individual case. On the opposite model, every individual has to opt in to a collective case. There are three primary justifications for an opt out model: achieving maximal deterrent effect, maximising procedural efficiency, and encouraging comprehensive settlement. Hence, Mulheron's comparison of initial opt out rates in the United States, Australia and Canada (not take up rates) found higher mean participation rates with opt out procedures (0%-40%) than opt in (0.03%-100%).<sup>15</sup>

However, although a class can be created by an opt out certification procedure and then processed without the involvement of class members other than the lead plaintiff, after a settlement has been negotiated class members normally, in classes where claimants are numerous and dispersed such as consumer claims at least, need to opt in so as to collect their individual entitlements. Data noted below indicate that opt in rates in consumer cases can be low.

Willing, Hooper and Niemic's 1996 data on four federal district courts identified 407 class actions, of which 152 (37%) were certified as class actions, 59 of which (39%) were certified for settlement purposes only.<sup>16</sup> The most frequently certified class was the Rule 23(b)(3) 'opt-out class' of which securities cases occurred in roughly 50% to 85% of the certified classes. The second most frequently certified class was the Rule 23(b)(2) or 'injunctive class', of which civil rights cases of various types were the most likely, which occurred in 17% to 44% of the certified classes.

Although the class action mechanism has a long history in USA,<sup>17</sup> usage unexpectedly took off in the mid-1960. This massive increase had three main origins: first, a crisis occurred in civil and social rights for which no clear political or social solution was available;<sup>18</sup> second, Rule 23 of the Federal Rules of Civil Procedure was liberalised in 1966 almost by accident; and third, those two elements combined with Congress' move to introduce a one-way fee shift in civil rights cases so as to

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<sup>15</sup> R Mulheron, *Reform of Collective Redress in England and Wales: A Perspective of Need, A Research Paper for submission to the Civil Justice Council of England and Wales* (London, Civil Justice Council, 2007).

<sup>16</sup> TE Willing, LL Hooper and RJ Niemic, *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* (Washington, D.C., Federal Judicial Centre, 1996).

<sup>17</sup> SC Yeazell, *From Mediaeval Group Litigation to the Modern Class Action* (New Haven, Yale University Press, 1987).

<sup>18</sup> SC Yeazell, 'Brown, the Civil Rights Movement, and the Silent Litigation Revolution' (2004) 57 *Vanderbilt Law Review* 1975-2003.

encourage their resolution through the courts.<sup>19</sup> Lawyers seized on the opportunities of expanding private enforcement, and Congress enacted ever more one-way fee shifts in preference to public enforcement of regulatory rules.<sup>20</sup>

It should be remembered that individual cases can be aggregated through various other techniques, including consolidated trials, protection and reorganization under bankruptcy, and informal aggregation.<sup>21</sup> An important further procedure used by Federal judges for collecting similar class actions together for coordinated pre-trial processing is under the multi-districting rule (MDL).<sup>22</sup> The Panel has power to make such a transfer of similar class cases across the country, and thereafter a single court case manages the cases together before, in theory, returning them to their originating jurisdictions for trial. The MDL procedure has been found to have some advantages for plaintiffs (through increasing cost sharing, information sharing, and division of labour among multiple plaintiffs) and for defendants (notably over deposition of witnesses).<sup>23</sup> It can be favoured where claims do not satisfy the class action certification procedure, such as where individual product liability claims have multiple individual issues.

### Realities from empirical evidence

Empirical research into the real world of collective litigation builds up to a picture of reality that is strikingly different from the idealistic picture set out above. In the 1960s, class actions developed as a means of providing an 'avenue open to a minority to petition for redress of grievances',<sup>24</sup> using litigation as 'a form of political expression'.<sup>25</sup> Since then, the focus has shifted from social policy reform cases to issues of market regulation of business activity, addressing issues of consumer protection, safety, market competition, investor protection, prisoners' rights, environmental protection and genocide.

In contrast to the regulatory power directed at market participants, the US Government is generally immune from suit under the doctrine of sovereign immunity. The Federal Tort Claims Act (FTCA) provides a limited waiver for circumstances where the United States is acting in a manner akin to a private person (e.g. providing medical care at a Veterans Hospital) and where the private person would be liable under applicable state law. But the FTCA specifically exempts claims based on performance or non-performance of a discretionary function.

Issues of concern that will be examined below are selectivity in the types of cases pursued, transactional costs, reductions in levels of damages paid to plaintiffs, potential imbalance in the incentives for plaintiff lawyers to force defendants to settle irrespective of merits, conflicts of interest by plaintiff lawyers, and the potential for abuse, such as a tendency to target large companies, which

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<sup>19</sup> S Farhang, *The Litigation State. Public Regulation and Private Lawsuits in the U.S* (Princeton NJ, Princeton University Press, 2010).

<sup>20</sup> *ibid.*

<sup>21</sup> See DR Hensler, 'Revisiting the Monster: New Myths and Realities of Class Actions and Other Large Scale Litigation' (2001) *Duke Journal of Comparative & International Law* 179.

<sup>22</sup> 28 U.S.C. § 1407 (1997).

<sup>23</sup> SM Olson, 'Federal Multidistrict Litigation: Its Impact on Litigants' (1983) 13(3) *Justice System Journal* 341-64. See also Judicial Conference of the United States, Advisory Committee on Civil Rules, *Report of the Advisory Committee on Civil Rules and the Working Group on Mass Torts to the Chief Justice of the United States and to the Judicial Conference of the United States* (1999). See also MS Williams and TE George 'Who Will Manage Complex Civil Litigation?: The Decision to Transfer and Consolidate Multidistrict Litigation' (2013) 10(3) *Journal of Empirical Legal Studies* 424-461; DF D'Onfro, 'Multidistrict Litigation: A Surprising Bonus for Pro Se Plaintiffs and a Possible Boon for Consumers' (March 3, 2010), available at <http://ssrn.com/abstract=1563>.

<sup>24</sup> *NAACP v Button* 371 US 415 (1963) at 431.

<sup>25</sup> *ibid* at 429.

are regarded as ‘deep pockets’.<sup>26</sup> Despite the huge literature that asserts the doctrinal value of the US theory and practice of class actions, it is striking that the above issues are not more widely discussed, and there is a relatively limited quantity of reliable empirical research.<sup>27</sup> It should be stressed that the issues listed above are intentional features of the US policy on private enforcement of law, and hence may be regarded by some as acceptable. However, European politicians have rejected the US model as abusive.<sup>28</sup> Farhang has noted<sup>29</sup> that many US scholars suggest that, compared to administrative regulation, private enforcement regimes (1) produce inconsistency and uncertainty (since policy emanates from a multitude of litigants and judges); (2) mobilize less policy expertise; (3) are needlessly adversarial, subverting cooperation and voluntary compliance; (4) are extremely costly; and (5) are painfully slow and cumbersome.<sup>30</sup>

### *Type selectivity*

Studies have shown that certain types of class actions occur far more frequently than others. This is unsurprising given that decisions on investing in cases are taken by private intermediaries based on their own discretion, which will frequently be based largely on maximising personal income and reputation. One consequence of the American policy of private enforcement has been called a systemic failure of the ability for ordinary citizens to solve their legal problems, despite the seemingly high volume of litigation in the country. Hadfield has identified that the incidence of reported problems for individuals in a number of first world states is relatively consistent, with the exception of Japan, which reports lower rates.<sup>31</sup> However, she found a striking difference in the rate at which people do nothing in response to legal difficulties between the United States (29 per cent or higher),<sup>32</sup> the United Kingdom (3-5 per cent), The Netherlands (10 per cent) and Slovakia (18 per cent), which she attributed to the availability of substantially more resources in the latter three states than in the

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<sup>26</sup> JC Alexander, ‘Do the Merits Matter? A Study of Settlements in Securities Class Actions’ (1991) 43 *Stanford Law Review*, 497 (finding that every company in the cohort of companies making an initial public offering (IPO) with a market loss over \$20 million was sued but smaller IPOs were not sued).

<sup>27</sup> A summary of the empirical research on various aspects of US class actions, including some aspects not covered below, was N Pace, ‘Class Actions in the United States of America: An Overview of the Process and the Empirical Literature’ (2007), available at [http://globalclassactions.stanford.edu/sites/default/files/documents/USA\\_\\_National\\_Report.pdf](http://globalclassactions.stanford.edu/sites/default/files/documents/USA__National_Report.pdf). He also noted a number of reasons why little data has been collected, and the limitations of existing data. The current compilation has reviewed all the original sources, cross-checked with Pace’s summary, and added more recent studies.

<sup>28</sup> Green Paper on Consumer Collective Redress, COM(2008) 794, 27.11.2008, para. 48 (US-style class actions are unacceptable in the EU since they produce ‘abuse’ caused by a ‘toxic cocktail’ of causes that are not part of European legal traditions and should not be permitted in the EU); European Parliament resolution of 2 February 2012 on ‘Towards a Coherent European Approach to Collective Redress’ 2011/2089(INI), para 2 (noted “efforts made by the US Supreme Court to limit frivolous litigation and abuse of the US class action system” and stressed that Europe “must refrain from introducing a US-style class action system or any system which does not respect European legal traditions”); Communication from the Commission “Towards a European Horizontal Framework for Collective Redress”, COM(2013) 401/2, 11.6.2013 (collective actions “must not attract abusive litigation or have effects detrimental to respondents regardless of the results of the proceedings. Examples of such adverse effects can be seen in particular in ‘class actions’ as known in the United States. The European approach to collective redress must thus give proper thought to preventing these negative effects and devising adequate safeguards against them.”)

<sup>29</sup> S Farhang ‘Public Regulation and Private Lawsuits in the American Separation of Powers System’ (2008) 52 *American Journal of Political Science* 821.

<sup>30</sup> E Bardan and R Kagan *Going by the Book* 2002; F Cross, ‘Rethinking Environmental Citizen Suits’ (1989) 8 *Temple Environmental Law & Technology Journal* 55, 67-69; RA Kagan, *Adversarial Legalism: The American Way of Law* (Boston, Harvard University Press, 2001); RB Stewart and CR Sunstein, ‘Public Programs and Private Rights’ (1981-1982) 95 *Harvard Law Review* 1193.

<sup>31</sup> GK Hadfield, ‘Higher Demand, Lower Supply? A Comparative Assessment of the Legal Resources Landscape for Ordinary Americans’ (2009) 37 *Fordham Urban Law Journal* 129. She compared data from a number of surveys of ‘justiciable needs’ surveys of individuals in England, Japan, the Netherlands, Scotland, Slovakia and the USA.

<sup>32</sup> *Supporting Justice: A Report on the Pro Bono Work of America’s Lawyers* (American Bar Association, 2005).

United States that are devoted to the provision of problem solving and legal services for ordinary citizens. She concluded that the problem lies in the fact that overseeing and regulating legal services and satisfying the demand for problem solving is overseen by central government in the other states but left to private market providers, principally the Bar, in the United States, and that this results in a significant gap in provision. She contrasted the extensive availability in the United States of *ex ante* legal advice for corporate work with its complete absence for ordinary US citizens, which she illustrated by reference to the complexity of mortgage refinancing agreements.<sup>33</sup>

Several studies have found that securities cases are consistently by far the largest category of class actions. The survey led by Hensler of all class actions identifiable in 1995-1996 found that securities and financial injury matters exceeded mass tort cases, and social policy reform cases comprised only a minority.<sup>34</sup>

Eisenberg and Miller’s study of class actions approved by courts between 1993 and 2002 found that the breakdown of cases was securities 39%, consumer 18%, antitrust 10%, labour and employment 8%, employee benefits 6%, and civil rights 3%.<sup>35</sup> Fitzpatrick’s study of all 668 class action settlements approved by federal judges in 2006-2007 found the breakdown to be as shown in Table 1.<sup>36</sup> He found the following breakdown on subject types, in which securities cases dwarfed other types:

Table 1. Breakdown of approved settlements in federal class actions 2006-2007

Subject matter	Number of settlements	
	2006	2007
Securities	122 (40%)	135 (35%)
Labour and Employment	41 (14%)	53 (14%)
Consumer	40 (13%)	47 (12%)
Employee Benefits	23 (8%)	38 (10%)
Civil Rights	24 (8%)	37 (10%)
Debt Collection	19 (6%)	23 (6%)
Antitrust	13 (4%)	17 (4%)
Commercial	4 (1%)	9 (2%)
Other	18 (6%)	25 (6%)
<b>Total</b>	<b>304</b>	<b>384</b>

Fitzpatrick found that distribution of subject areas in settlement classes did not differ much from non-settlement classes, with two exceptions. One exception was consumer cases, which were nearly three times as prevalent among settlement classes (15.9%) as non-settlement classes (5.9%); the other was civil rights cases, which were four times as prevalent among non-settlement classes (18.0%) as settlement classes (4.5%).

<sup>33</sup> LE Wills ‘Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price’ (2006) 65 *Maryland Law Review* 707.

<sup>34</sup> DR Hensler, B Dombey-Moore, B Giddens, J Gross, EK Moller and NM Pace, *Class Action Dilemmas. Pursuing Public Goals for Private Gain* (RAND Institute for Civil Justice, 2000).

<sup>35</sup> T Eisenberg and GP Miller, ‘Attorney Fees in Class Action Settlements: An Empirical Study’ (2004) 1(1) *Journal of Empirical Legal Studies* 27-78.

<sup>36</sup> BT Fitzpatrick, ‘An Empirical Study of Class Action Settlements and their Fee Awards’ (2010) 7(4) *Journal of Empirical Legal Studies* 811-846. Fitzpatrick ascribed the differences to the fact that his data set comprised federally approved settlements whereas Eisenberg and Miller’s included state courts, relied on published opinions and excluded fee-shifting cases.

It would be logical to assume that expert lawyers would prefer to concentrate on cases that would maximise their income. Kritzer has illuminated the fact that local law firms respond to the cases that are brought to them.<sup>37</sup> However, the most lucrative types of class action case are clearly concentrated in a small number of law firms, who aim to commence actions quickly in response to external stimuli and thus pre-empt competitors.

Evidence of concentration and expertise amongst class counsel, indicating the ability to gain high fees, appeared from a 1996 study by Willging, Hooper and Niemic. It was found that 12 of the 160 law firms in its 156 cases served as lead or co-lead counsel in 4 or more cases.<sup>38</sup> In total, these 12 firms appeared 95 cases, 63% of the certified cases in the study. The median cost of notice in the limited number of cases with data available exceeded \$36,000 for notice of certification or settlement or both. In cases where benefits to the class could readily be quantified, the “fee-recovery rate” (fee awards as a percentage of the gross settlement amount) infrequently exceeded the traditional 33.3% contingency fee rate. The fee-recovery rate exceeded 40% in 11% or fewer of settled cases, half of which included non-quantifiable benefits such as a permanent injunction.

Further evidence of concentration was found in a study of 755 securities class actions cases settled between December 1995 and August 2005, in which settlements totalled \$25.4 billion, five law firms handled 70% of the cohort of 755 cases, with one firm handling 43% of the cohort and generating fees and expenses of \$1.7 billion.<sup>39</sup>

Nora Freeman Engstrom has drawn attention to the tens of thousands of individual claims that are settled outside the courts through high-volume personal injury law practices that aggressively advertise and mass produce the resolution of claims with defendant insurers, typically with little client interaction, cursory investigation of facts, without initiating lawsuits, much less taking claims to trial (‘settlement mills’).<sup>40</sup> She suggested that such repeat players agree claims at settlement sums based not on trial-centred precedents but on formulaic going rates based on previous settlements tied to the gravity of the claimant’s injury (akin to a no fault tariff), on the basis that this cooperation was economically profitable in avoiding litigation.

### ***Studies on case types***

This section notes the findings of some of the main empirical studies of important types of US class actions.

#### **Securities**

Securities class actions claiming damages have occurred extensively throughout several decades.<sup>41</sup> Formal approval of the policy of deterrence was given in the Supreme Court’s recognition of private

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<sup>37</sup> HM Kritzer, *The Justice Broker* (New York, Oxford University Press, 1990) (finding little relationship between the type of fee arrangement and the amount of time that lawyers invest in their cases); HM Kritzer, ‘Lawyer Fees and Lawyer Behaviour in Litigation: What Does the Empirical Literature Really Say?’ (2002) 80 *Texas Law Review* 1943.

<sup>38</sup> TE Willging, LL Hooper and RJ Niemic, *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* (Washington, D.C., Federal Judicial Centre, 1996).

<sup>39</sup> AV Thakor, JS Nielsen and DA Gulley, *The Economic Reality of Securities Class Action Litigation* (Navigant Consulting and the US Chamber Institute for Legal Reform, 2005).

<sup>40</sup> NF Engstrom, ‘Run-of-the-Mill Justice’ (2009) 22 *Georgetown Journal of Legal Ethics* 148.

<sup>41</sup> See <http://securities.stanford.edu>. See also Cornerstone Research, *Securities Class Action Filings. 2008: A Year in Review* (2009); and annual surveys by NERA, such as R Comolli and S Starykh, *Recent Trends in Securities Class Action Litigation: 2014 Full-Year Review Settlement amounts plummet in 2014, but post-Halliburton II filings rebound* (NERA, 2015).

rights of action under the securities laws.<sup>42</sup> Enforcement actions taken by the Securities and Exchange Commission (SEC) imposing regulatory penalties as an alternative to damages seem to be used in different scenarios to class actions, and occurred rarely before 2006.<sup>43</sup> The Private Securities Litigation Reform Act of 1995 (PSLRA)<sup>44</sup> enabled shareholders to allege any violation of section 10(b)-5 of the Securities Exchange Act 1934, which was widely drawn and prohibits *inter alia* any manipulation and deceptive practices by managers and corporations and prescribes managerial duties.<sup>45</sup> In 2006 and 2007, a series of reports raised concerns over the risk of litigation to corporate markets.<sup>46</sup>

Since 1997, there have been roughly 200 to 250 federal securities class actions annually, with the exception of a spike of 508 in 2001 and trough of 132 in 2005.<sup>47</sup> Cases alleging violation of Rule 10b-5, Section 11 and/or Section 12 are regarded as ‘standard’ securities cases, and constitute the majority, with a smaller number of merger objection cases, and some other types.<sup>48</sup> More than half of the cases in the past five years have consistently involved the three sectors of health technology and services, finance, and electronic technology and technology services industries.<sup>49</sup> The median time from the end of the proposed class period to filing of the case has fallen from 30 days in 2010 to 17 days in both 2013 and 2014.<sup>50</sup>

In 2014, a motion to dismiss was filed in 95% of the securities class action tracked in the NERA data, and the court reached a decision in 80% of the motions filed.<sup>51</sup> Of such motions, 48% were granted, 26% were granted in part and denied in part, and 21% were denied.<sup>52</sup> Most securities class actions in 2014 (73%) were settled or dismissed before a motion for class certification was filed.<sup>53</sup> Thus, only 15% of such cases filed reached a decision on the motion for class certification. Of the 2014 cases analysed by NERA, 13% resolved in less than a year, 25% took between 1 and 2 years to resolve, 21% took between 2 and 3 years, and 26% took more than 4 years to resolve.<sup>54</sup>

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<sup>42</sup> *Herman & MacLean v Huddleston*, 459 US 375, 380 (1983);

<sup>43</sup> J Larsen, E Buckberg and B Lev, ‘SEC Settlements: A New era Post-SOX’ (NERA, 2008).

<sup>44</sup> Pub. L. No. 104–67, 109 Stat. 737 (1995). This amended the Securities Act of 1933 and the Securities Exchange Act of 1934, and is codified in scattered sections of 15 U.S.C.

<sup>45</sup> Duties can be divided into those for individuals (violation of duty; against managers who breach duty of loyalty); and the entity (violation of duty of care, which requires the execution of ‘reasonable skills, diligence and especially taking care in board actions’).

<sup>46</sup> Committee on Capital Markets Regulation, Interim Report (2006) [http://www.capmkts.org/pdfs/11.30Committee\\_Interim\\_ReportREV2.pdf](http://www.capmkts.org/pdfs/11.30Committee_Interim_ReportREV2.pdf) (Paulson Committee; noting the growth in private equity and heightened exposure to litigation related to disclosures for public companies); Commission on the Regulation of US Capital Markets in the 21<sup>st</sup> Century, Report and Recommendations (2007) available at <http://www.capitalmarketscommission.com> (recommend that any private suit should take into consideration sums recovered by the SEC under s308 of the Sarbanes-Oxley Act, which permits the SEC to direct to injured parties any monies recovered from fines or disgorgement remedies (Fair Fund authority, used frequently; expressed concern over ongoing viability of the Big Five accounting firms and suggested binding arbitration as an alternative to class litigation); McKinsey & Co., *Sustaining New York’s and the US’ Global Financial Services Leadership* (2007) available at [http://www.schumer.senate.gov/SchumerWebsite/pressroom/special\\_reports/2007/NY\\_REPORT%20FINAL.pdf](http://www.schumer.senate.gov/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20FINAL.pdf); MR Bloomberg and CE Schumer, *Sustaining New York’s and the US’s Global Financial Services Leadership* (2007).

<sup>47</sup> R Comolli and S Starykh, *Recent Trends in Securities Class Action Litigation: 2014 Full-Year Review Settlement amounts plummet in 2014, but post-Halliburton II filings rebound* (NERA, 2015).

<sup>48</sup> *ibid.*

<sup>49</sup> *ibid.*

<sup>50</sup> *ibid.*

<sup>51</sup> *ibid.*

<sup>52</sup> *ibid.*

<sup>53</sup> *ibid.*

<sup>54</sup> *ibid.*

Securities class actions have been strongly criticised. In 1991 Alexander asserted that recovery depended on the occurrence of the triggering event of a large loss, and did not require proof that a securities violation had actually occurred.<sup>55</sup> The result was that securities class actions operated as insurance against market losses but only benefited a small number of institutional investors against market losses from a speculative investment, and benefited small investors little, whilst destroying shareholder value. In 2004 Choi expressed concern over three problems: frivolous suits; lack of incentives for plaintiff attorneys to focus on smaller companies; and the agency problem between plaintiffs' attorneys and the plaintiff class.<sup>56</sup> Frivolous suits appeared to be encouraged by the fact that Directors' and Officers' insurance policies would not pay if directors or officers were found guilty of violating the securities laws, so cases often settle irrespective of merits in order to maintain insurance cover.

Coffee asserted in 2006 that securities class actions impose enormous penalties but achieve little compensation and limited deterrence, because of basic circularity: damages imposed on a corporation fall on diversified shareholders.<sup>57</sup> This induces pocket-shifting wealth transfers among shareholders. The equilibrium benefits corporate insiders, insurers and plaintiffs' attorneys but not investors, especially employees or smaller 'buy and hold' investors. Such an enforcement policy was contrary to public policy, which was that large financial penalties should be avoided when they fall inequitably on innocent shareholders.<sup>58</sup> If stockholders keep their investment, the damages claim is circular because they partially fund the settlement payment, and suffer an ongoing lower stock price.<sup>59</sup> Such actions may effectively deter firms from issuing shares or making forward predictions. There is evidence that certain types of nuisance claims are encouraged.

Coffee noted that securities settlements only recover a very small share of investor losses: the annual ratio of settlements to losses published by NERA never exceeded 7.2% in cases recorded from 1991 to 2004, and had recently been under 3%, whereas attorney costs constituted 32% of settlements.<sup>60</sup> He noted that senior management were highly likely to be named as defendants, but not outside directors or auditors (4%) or underwriters. However, such insiders rarely contributed financially to the settlement.<sup>61</sup> Where the defendant was a solvent corporation, its insurer would cover everything up to the policy limits, and the corporation would pick up the balance. Since the cost of insurance falls on shareholders, the deterrent rationale was undercut; it rested at best on enterprise liability, inducing increased monitoring of the corporate officials.

Based on the 2005 filing rate, Miller *et al.* found that over a five-year period the average public corporation faced a 10% probability that it would face at least one shareholder class action.<sup>62</sup>

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<sup>55</sup> JC Alexander, 'Do the Merits Matter? A Study of Settlements in Securities Class Actions' (1991) 43(3) *Stanford Law Review* 497-598.

<sup>56</sup> SJ Choi, 'The Evidence on Securities Class Actions' (2004) 57 *Vanderbilt Law Review* 1465-1525.

<sup>57</sup> JC Coffee, Jr, 'Reforming the Securities Class Action: An Essay on Deterrence and its Implementation' (2006) 106 *Columbia Law Review* 1534.

<sup>58</sup> Press Release, U.S. Securities & Exchange Commission, Statement of the Securities and Exchange Commission Concerning Financial Penalties (January 4, 2006).

<sup>59</sup> JD Cox and RS Thomas, with D Kiku, 'Does the Plaintiff Really Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions' (2006) 106 *Columbia Law Review* 1587-1940.

<sup>60</sup> JC Coffee, Jr, 'Reforming the Securities Class Action: An Essay on Deterrence and its Implementation' (2006) 106 *Colum LR* 1534.

<sup>61</sup> FC Dunbar, VM Juneja and DN Martin, 'Shareholder Litigation: Deterrent Value, Merit and Litigants' Options' (NERA, 1995), available at SSRN <http://ssrn.com/abstract=10181>, found that insurers paid 68.2% and corporations 31.4%, so at most 0.4% was paid by individual directors. B.S. Black, B.R. Cheffins and M. Klausner, 'Outside Director Liability' (2006) 58 *Stanford Law Review* 1055-1159.

<sup>62</sup> RI Miller, T Foster & E Buckberg, *Recent trends in Shareholder Class Action Litigation: Beyond Mega-Settlements, is Stabilization Ahead?* (NERA, 2006). The annual likelihood rose from 1.6% in 1995 to 1.9% in 2005.

However, they found that the probability of dismissal rose from 19.4% in 1993-5 to 40.3% in 2003-5, attributed to the introduction of the PSLRA. In 2014, Krishnan *et al.* found that 12 per cent of all merger and acquisition offers were challenged in the courts in 1999 and 2000 across the USA.<sup>63</sup> They found that half of the litigation was filed in Delaware, where there were fewer barriers to deal completion than in federal courts. In the years before 2014, Coffee and Palia noted that hedge fund activism had increased almost hyperbolically, and hedge funds formed ‘wolf packs’ in pursuit of financial gains, albeit with mixed results.<sup>64</sup>

The PSLRA imposed various reforms,<sup>65</sup> including establishing a preference for institutional shareholders to serve as lead representative plaintiffs; setting limits on individual shareholders’ eligibility to serve as representative plaintiffs and on their compensation therefrom; establishing new notice provisions; and mandating disclosure of settlement terms to class members and prohibiting sealed settlements in most circumstances. This had been introduced because Congress believed that the securities class action needed an ‘owner’ of the suit’s outcome, and the lawyer’s weak incentives to pursue aggressively a meritorious action were not overcome by the self-interest of members of the class.<sup>66</sup> It had been asserted that lawyers maintained lists of potential plaintiffs and their stockholdings, and that a judge was overwhelmed by a crowded docket and not capable of effectively protecting the interests of the class. The reform was adopted to encourage the largest stockholder to be the class representative: that stockholder was expected to actively monitor class counsel’s conduct and reduce costs. It was hoped to change the behaviour of lawyers – no longer a ‘race to courthouse’. In response to charges that plaintiff class action attorneys had begun filing securities fraud cases in state courts to evade the 1995 Act, Congress passed the Securities Litigation Uniform Standards Act of 1998<sup>67</sup> to provide for removal of state class actions to the federal courts except in certain specified circumstances.

Cox and Thomas’ 2006 study of the ten year impact of PSLRA noted cases in which lead plaintiffs had been able to negotiate lower attorneys’ fees.<sup>68</sup> However, they also noted the following. There was frustration over settlements where plaintiffs had a large continuing ownership stake in the defendant, with result that the settlement was partly borne by the plaintiff itself. The system threatened ongoing commercial relations: the data contained no case where a bank, mutual fund or insurance company acted as lead plaintiff in a securities class action. There were some concerns over becoming lead plaintiff, such as the threat of discovery; time spent in managing; risk of disclosure of proprietary non-public information; and threat of suit by other disgruntled plaintiffs. Major investors preferred to bring their own individual suit. Weaker claims diluted large or strong claims. The largest investors rarely owned more than 5% of a company’s stock, so needed to act as a group. Lawyers continued to have large stakes in claims, and there was evidence of ‘pay-to-play’ practices, such as contributions by lawyers to political campaigns to public fund officials. Overall, many institutions were reluctant to assume the lead plaintiff role, especially in smaller cases. Institutions were lead plaintiffs in only 5%-10% of the cases. There was a minimum claim size of \$1 million necessary for an institution to be a lead plaintiff; and public pension fund lead plaintiffs had the most potential to improve client

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<sup>63</sup> CNV Krishnan, RW Masulis, RS Thomas and RB Thompson, ‘Jurisdictional Effects in M&A Litigation’ (2014) 11(1) *Journal of Empirical Legal Studies* 132-158.

<sup>64</sup> JC Coffee, Jr, and D Palia, ‘The Impact of Hedge Fund Activism: Evidence and Implications’, European Corporate Governance Institute (ECGI) - Law Working Paper No. 266/2014, Columbia Law and Economics Working Paper No. 489.

<sup>65</sup> In 1994, settlements from all securities class action law suits totalled \$899 million: M Bajaj, SC Mazumadar and A Sarin, ‘Securities Class Action Settlements: An Empirical Analysis’ (2003) 43 *Santa Clara Law Review* 1001-1033

<sup>66</sup> The explanation in this paragraph draws on JD Cox and RS Thomas, with D Kiku, ‘Does the Plaintiff Really Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions’ (2006) 106 *Columbia Law Review* 1587.

<sup>67</sup> Pub. L. 105–353, 112 Stat. 3227 (1998); codified in scattered sections of 15 U.S.C., including § 78bb(f)(1).

<sup>68</sup> JD Cox and RS Thomas, with D Kiku, ‘Does the Plaintiff Really Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions’ (2006) 106 *Columbia Law Review* 1587.

monitoring of class counsel. In 388 class actions, PSLRA had had no significant impact on settlement size, and the researchers wondered whether it was ‘worth the candle’. In a cohort of 35 settlements, lead plaintiff public pension funds had much larger dollar claims than other types of lead plaintiffs and they represented a much larger percentage (4%) of the claims filed in the case. That contrasted with where single individual investors were lead plaintiffs, who had the smallest average dollar claims and represented on average the smallest percentage (0.11%) of the claims filed in cases. Hence, the data suggested that only institutional investor lead plaintiffs had large enough stakes in these cases to justify active monitoring of the class counsel. The researchers found no significant difference between pre- and post-PSLRA cases in respect of almost every characteristic: settlement amounts, length of class period, size of defendant firm, estimated provable losses. Only institutional investor lead plaintiffs appear to be associated with any difference in those metrics. The investigators were shocked to find that the ratio of settlement amounts to provable losses was *lower* in the post-PSLRA period. Thus, investors were worse off because they recovered a lower percentage of their losses.

In 2008 Cox, Thomas and Bai proceeded to review a cohort of 773 securities class actions settled from 1993 through 2005.<sup>69</sup> They found that the strength of the complaint matters a lot to the settlement, from which they refuted Alexander’s assertion that merits were irrelevant in securities class actions. There was evidence of support for the PSLRA lead plaintiff provision: 18% of securities class actions had been prosecuted by institutional plaintiffs (labor union pension funds, public pension funds, other institutions, as opposed to individuals or groups of individuals), as desired by Congress, and they added substantial value to the outcome. SEC enforcement action had a dramatic impact on the dynamics of settlements. The researchers confirmed their 2006 finding for the post-PSLRA period (see above), that institutions were more likely to intervene in cases with larger estimated provable losses, against firms with greater total assets, and where the SEC had undertaken enforcement action. The length of the class action period (a proxy for the extent of wrongdoing and number of investors) was insignificant. There were some causes for disquiet: 20.5% of settlements were below \$2 million, with the median settlement half that ceiling. These cases were settled more quickly, had shorter class action periods, had significantly lower provable loss, and yielded investors a lower recovery on their provable losses than did larger settlement cases (called ‘strike suits’). Small settlements arose in small capitalization firms in which there were relatively few injured investors and, thus, low levels of provable losses: but the settlements appeared to recoup roughly the same amount relative to the sum lost by investors.

There is evidence that it is the filing of a class action, rather than publicity of the occurrence of the underlying illegality, that undermines public confidence and causes the stock price to fall.<sup>70</sup> Effects on stock prices are different depending on the type of case.<sup>71</sup> Thus, accounting fraud has an ongoing depressing effect, whereas governance problems and illegal business practices have ongoing but limited adverse effects, and the price recovers quickly after insider trading. Some ‘strike suits’ occur, i.e. cases below \$2 million that are settled quickly for perhaps half that figure on a nuisance basis.<sup>72</sup>

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<sup>69</sup> JD Cox, RS Thomas, L Bai, ‘There Are Plaintiffs and ... There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements, (2008) 61(2) *Vanderbilt LR* 355.

<sup>70</sup> R Bauer and R Braun, ‘Long-Term Performance of Distressed Firms: The Role of Class Action Lawsuits’ Netspar, Discussion paper 10/2010-007, January 21, 2010 at <http://arno.uvt.nl/show.cgi?fid=100123>; L Bai, JD Cox, RS Thomas, ‘Lying and Getting Caught: An Empirical Study of the Effect of Securities Class Action Settlements on Targeted Firms’ (2011) 158 *University of Pennsylvania Law Review* 1877.

<sup>71</sup> R Bauer and R Braun, ‘Long-Term Performance of Distressed Firms: The Role of Class Action Lawsuits’ Netspar, Discussion paper 10/2010-007, January 21, 2010 at <http://arno.uvt.nl/show.cgi?fid=100123>.

<sup>72</sup> Cox, Thomas and Bai found 20% of cases were of this type: JD Cox, RS Thomas, L Bai, ‘There Are Plaintiffs and ... There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements, (2008) 61(2) *Vanderbilt Law Review* 355-386.

In 2010, Bauer and Braun reviewed the evidence on how shareholder class litigation affected the performance of companies,<sup>73</sup> on the assumption<sup>74</sup> that it acts as a governance mechanism, and that litigation is the central punishment device available for shareholders.<sup>75</sup> They noted that equity-linked incentives constitute a major part of American directors' and officers' total compensation,<sup>76</sup> so shareholder litigation also materially affects their overall pay package. In addition, there was a significant amount of reputational risk at stake for managers of sued corporations.<sup>77</sup> Bauer and Braun confirmed that lawsuits occur in response to bad stock price performance, as predicted.<sup>78</sup> They suggested that if stock prices do not recover over medium to long horizons this implies that shareholders in the aggregate market lose out and only plaintiffs gain. If share prices recover but bankruptcy risk increases, there is a wealth transfer from creditors to shareholders. They concluded that class action lawsuits are a powerful tool to discipline managers, and have a reasonable ability to exert influence on distressed firms without any wealth transfer being involved.

Baker and Griffith's 2009 study interviewed with plaintiffs' and defense lawyers, D&O insurance claims managers, monitoring counsel, brokers, mediators, and testifying experts. They found that, although securities settlements were influenced by some factors that were arguably merit related, such as the 'sex appeal' of a claim's liability elements, they were also influenced by many that were not, including, most obviously, the amount and structure of D&O insurance. The virtual absence of adjudication resulted in payment to the plaintiffs' class for every claim surviving the motions stage and, as importantly, a lack of authoritative guidance about merit at settlement.<sup>79</sup>

Bauer and Braun identified that the main reasons for shareholders to sue a corporation in the period 1996 to 2007 were false/misleading statements/failure to disclose (391 cases), stock price manipulation (331 cases) and illegal business practices (220 cases). A 'triggering event' (material correction of management's earnings forecasts) preceded the filing of the lawsuit in over 55% of cases. The most litigation-vulnerable sectors in the cohort were capital intensive and large industries, such as retail and manufacturing. They confirmed that large firms were sued for their deep pockets.<sup>80</sup> An out-of-court settlement was proposed in 91% of cases.<sup>81</sup>

They found that for allegations involving the corporate entity as a whole, a class action is highly disruptive. In the short run, the filing of a class action is a materially adverse corporate event, and long-term economic and financial effects depend on the nature of the allegations. There was a slight recovery in stock price immediately after filing, and the price then sharply reverses and gradually declines (to a minimum of -23% CAR) remaining down over the following three years. They commented that 'On average, shareholder litigation does not seem to pay off in terms of stock price

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<sup>73</sup> R Bauer and R Braun, 'Long-Term Performance of Distressed Firms: The Role of Class Action Lawsuits' Netspar, Discussion paper 10/2010-007, January 21, 2010 at <http://arno.uvt.nl/show.cgi?fid=100123>.

<sup>74</sup> M Becht, P Bolton and A Röell, 'Corporate Governance and Control' in G Constantinides, A Harris and R Schultz (eds), *Handbook of The Economics of Finance – Volume 1A: Corporate Finance* (Amsterdam, North-Holland Publishers, 2003)

<sup>75</sup> L Peng and A Röell, 'Executive Pay and Shareholder Litigation' (2008) 12(1) *Review of Finance* 141-184.

<sup>76</sup> BJ Hall and JB Liebman, 'Are CEOs Really Paid Like Bureaucrats?' (1998) 113(3) *Quarterly Journal of Economics* 653-691.

<sup>77</sup> EM Fich and A Shivdasani, 'Financial fraud, director reputation, and shareholder wealth' (2007) 86 *Journal of Financial Economics* 306-336.

<sup>78</sup> P Povel, R Singh and A Winton, 'Booms, Busts and Fraud' (2007) 20(4) *Review of Financial Studies* 1219-1254.

<sup>79</sup> T Baker and SJ Griffith, 'How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements' (2009) 157 *University of Pennsylvania Law Review* 755.

<sup>80</sup> LL DuCharme, PH Malatesta and SE Sefcik, 'Earnings Management, Stock Issues, and Shareholder Lawsuits', (2004) 71 *Journal of Financial Economics* 27-49.

<sup>81</sup> EM Fich and A Shivdasani, 'Financial fraud, director reputation, and shareholder wealth' (2007) 86 *Journal of Financial Economics* 306-336.

recovery.’ The researchers inferred that shareholders aim for the settlement amount and dispose of any equity share in the company.

Any potential recovery and/or long term disciplining effect did not come at the expense of creditor groups. Thus, there was a disciplining effect. A lower market valuation suggests that firms are shunned by investors. There was a sharp decrease in profitability and net worth. Firms facing litigation were significantly distressed. (However, it may be asked how this distress converted into changed, desired behaviours by the company and its employees.)

Bai, Cox and Thomas considered the effect of class actions alleging financial fraud.<sup>82</sup> They first noted that other studies had found that executives linked to misrepresentations were frequently terminated,<sup>83</sup> and there was extensive literature on the perverse effects of stock-based compensation.<sup>84</sup> Some studies had found that there was no significant long term effect on stock price or operating performance for firms sued for fraud.<sup>85</sup> Studies do report a substantial reputational loss as measured by declines in the short term market values of their securities.<sup>86</sup> A consistent finding was that the disclosure of a financial fraud yields a large negative market reaction.<sup>87</sup>

Bai, Cox and Thomas then reviewed 480 companies who had settled securities class actions since 1996. They found notable and statistically significant negative changes, particularly with respect to their operations in terms of efficiency, short-term liquidity, overall financial health and stock market performance. For post-settlement periods, defendants with high settlement amounts had higher probability of under-performing. There was an indication that insurance did not provide full coverage of the settlement. The market price plummeted immediately after the start of the lawsuit, and did not recover even three years afterwards. Firms experienced statistically greater risks of financial stress than others. The researchers concluded that there was strong support for the view that suits are better directed towards the officers, advisors and other individuals who bear responsibility for the fraudulent representations than against companies.

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<sup>82</sup> L Bai, JD Cox, RS Thomas, ‘Lying and Getting Caught: An Empirical Study of the Effect of Securities Class Action Settlements on Targeted Firms’ (2011) 158 *University of Pennsylvania Law Review* 1877.

<sup>83</sup> JM Karpoff, DS Lee and GS Martin, ‘The Consequences to Managers for Financial Misrepresentation’ (2008) 88 *Journal of Financial Economics* 193, 201, 208, finding that 93.61 per cent of those identified in the government prosecution lose their job, and for responsible parties who are officers, 92.39 per cent lose their jobs; firing occurs more quickly when the board chair is not held by the firm’s chief executive officer.

<sup>84</sup> See T Baker, D Collins, and A Reitenga, ‘Stock Option Compensation and Earnings Management Incentives’ (2003) 18 *Journal of Accounting, Auditing & Finance* 557, 559 (noting decreasing earnings accruals associated with periods before options are granted to executives); E Bartov & P Mohanran, ‘Private Information, Earnings Manipulation and Executive Stock-Option Exercises’ (2004) 79 *The Accounting Review* 889, 891 (finding that income increasing accruals are systematically associated with higher levels of executive stock options); DB Bergstresser & T Philippon, ‘CEO Incentives and Earnings Management’ (2006) 80 *J Fin Econ* 511, 513 (finding that discretionary earnings accruals are associated with wealth gains associated with executive options); J Francis, P Olsson & K Schipper, *Call options and Accrual Quality* (Stockholm Institute for Financial Research, 2005) available at <http://www.sifr.org/Pdgs/sifr-wp34.pdf> (finding that the presence of option-based compensation worsens the quality of earnings accruals).

<sup>85</sup> D Marciukaityte, SH Szewczyk, H Uzun and R Varma, ‘Governance and Performance Changes after Accusations of Corporate Fraud’ (2006) 62 *Financial Analysts Journal*, May-June, 40.

<sup>86</sup> JM Karpoff, DS Lee, and GS Martin, ‘The Cost to Firms of Cooking the Books’ (2008) 43 *Journal of Financial & Qualitative Analysis* 581.

<sup>87</sup> See eg SP Ferris and AC Pritchard, ‘Stock Price reactions to securities Fraud Class Actions Under the Private Securities Litigation Reform Act’ 1 *University of Michigan John M Olin Centre for Law & Economics*, Paper No 01-009, 2001, available at [http://papers.ssrn.com/so13/papers.cfm?abstract\\_id=288216&rec=1&srcabs=251766](http://papers.ssrn.com/so13/papers.cfm?abstract_id=288216&rec=1&srcabs=251766) (finding ‘a large and statistically negative [stock market] reaction’ to ‘the revelation of potential fraud’); see also S Bhagat, J Bizjak & JL Coles ‘The Shareholder Wealth Implications of Corporate Lawsuits’ (1998) Winter, *Financial Management* 6-7 (reporting a loss of 0.97% of the market value of defendant firms’ equity during the two day period following the announcement of the lawsuit, but no significant loss in the two day period following settlement).

A 2010 study of 76 securities class actions in Canada between 1992 and 2006, and individual class actions that were filed in both Canada and the USA found that overall litigation exposure for Canadian companies remained relatively low when compared to that of companies in the United States. Canadian companies that were listed on stock exchanges in the United States faced the greatest litigation exposure, and cases involving them were costly to resolve. The findings were supported by insurance company data on Directors and Officers liability policy premiums for the largest 250 firms listed on the Toronto Stock Exchange between 2004 and 2006, which illuminated issues such as risks of being a director and different approaches towards offsetting or not offsetting court costs and the cost of settlements.

Palmer and Sanders found that stock market reaction to ‘blockbuster’ jury damages awards (amounting to \$100 million or more) was trivial in 11 of a set of 17 cases identified in 2004, and reaction only occurred where the ratio of total award to market capitalization was in excess of 9%.<sup>88</sup> They concluded that awards that seem large are unimportant to (deep pocket) companies that have much larger market capitalisation, despite the fact that they face almost constant litigation.

Erickson’s 2011 analysis of over 700 different types of corporate lawsuits (including shareholder derivative suits, securities class actions, SEC enforcement actions, and criminal prosecutions) revealed that they do not target different types of corporate wrongs, but often target the same alleged misconduct, the same defendants, and the same corporate coffers.<sup>89</sup> Her data demonstrated that certain types of lawsuits consistently outperform others, creating a litigation hierarchy within corporate law. She concluded that those findings ‘raise critical questions about traditional theories of deterrence, suggesting that more may not always be better when it comes to combating corporate fraud’.

Perino analysed 731 settlements to study the effect to which the PSLRA’s lead plaintiff provision had enlisted institutional investors to monitor class counsel in order to curb the agency costs endemic in securities class actions.<sup>90</sup> He reported in 2012 that, even when controlling for institutional self-selection of potentially easier or higher-quality cases, cases with public pension lead plaintiffs had larger recoveries and lower fee requests and fee awards than cases with other lead plaintiff types. Fee requests were 5.3% less, and fee awards 3.4% less, although fee awards in cases without public pension lead plaintiffs had declined as well by 2.2%.

Baker, Perino and Silver reported in 2013 on 134 securities fraud class actions that settled between 2007 and 2011 in the three federal district courts that processed the largest numbers of these cases (the Southern District of New York and the Central and Northern Districts of California).<sup>91</sup> They found that fee agreements played little role in the lead plaintiff selection process, but were more important at the fee-award stage. On average, fee requests were smaller in cases with evidence of ex ante fee agreements than in cases without them (13.2% vs. 25.4%), a difference that remained statistically and economically significant in regressions that controlled for other case characteristics. Judges cut the requested attorneys’ fees in 19.7% of cases without evidence of an ex ante fee agreement but in only 5.9% of cases with such evidence, although this difference was not statistically significant because of sample size.

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<sup>88</sup> M Palmer and TB Sanders, ‘Surprise! Most Blockbuster Jury Awards Are Ignored By The Stock Market’ (2010) 6(2) *Review of Law & Economics* 145–166.

<sup>89</sup> JM Erickson, ‘Overlitigating Corporate Fraud: An Empirical Examination’ (2011) 96 *Iowa Law Review* 49.

<sup>90</sup> MA Perino, ‘Institutional Activism Through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions’ (2012) 9(2) *Journal of Empirical Legal Studies* 368–392.

<sup>91</sup> LA Baker, MA Perino and C Silver, ‘Setting Attorneys’ Fees in Securities Class Actions: An Empirical Assessment’ (2013) 66(6) *Vanderbilt Law Review* 1677.

The same authors reported in 2015 on all of the 434 securities class actions that settled in federal district courts from 2007 through 2012.<sup>92</sup> They found, first, that federal judges often deviate from the requirement of PSLRA that lead plaintiffs should set the terms of class counsel's retention and federal judges should serve as backstops against abuses. Second, fees tended to be lower in federal districts that saw a high volume of securities class actions than in districts that handled these cases less frequently. Third, fee cuts were significantly more likely among judges that saw a high volume of securities class actions than among judges with lower volumes. Fourth, in high-volume districts fee percentages declined as settlements become larger (known as the 'decrease-increase' rule). Fifth, judges appeared to cut fees randomly, on the basis of their own predilections rather than the merits of fee requests. Sixth, the general rule that judges should consider the 'time and labor expended by counsel' and other factors to ensure against excessive fees ('lodestar cross-checks') accomplished nothing. Actual fee awards reflected something closer to a pure 'percentage of the fund' approach.

### Tort claims

From the 1960s to the mid-1990s mass tort cases, notably against manufacturers of pharmaceuticals,<sup>93</sup> aircraft, motor vehicles and tobacco, were a considerable focus of class actions. A major structural consideration in the purpose of injury compensation has been to provide cover for the cost of healthcare through the tort system. In 2004 15.7% of American's population were without health insurance coverage, 59.8% were covered by employment-based health insurance, and 27.2% were covered by government health insurance programmes.<sup>94</sup> A review of 312 product liability and 297 non-product liability litigation events against automotive manufacturers found that the frequency of law suits was generally proportionate to the market share of companies.<sup>95</sup>

However, a sequence of decisions in the mid-1990s made certification more difficult, partly because of concern that certification out defendants under intense pressure to settle (discussed below), and partly Supreme Court decisions such as *Castano v American Tobacco Company*<sup>96</sup> and *In re: Rhone-Poulenc Rorer, Inc.*,<sup>97</sup> holding to a strict interpretation of the Rule 23 requirements, notably that the proposed class contained claims in which common issues did not predominate over individual issues.

After these decisions, commentators predicted that products liability plaintiffs would file fewer class actions in federal court, perhaps moving such filings to state courts whenever possible.<sup>98</sup> In fact, the number of personal injury lawsuits remained fairly steady, and cases were shifted to the MDL procedure, leading to an increase in non-class settlements.<sup>99</sup> Further, claims arising out of the 9/11

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<sup>92</sup> LA Baker, MA Perino and C Silver, 'Is the Price Right? An Empirical Study of Fee-Setting in Securities Class Actions' (2015) *Columbia Law Review* (forthcoming).

<sup>93</sup> See eg M Green, *Bendectin and Birth Defects: The Challenges of Mass Toxic Substances Litigation* (Philadelphia, University of Pennsylvania Press, 1996).

<sup>94</sup> U. S. Census, 2005. See also SD Sugarman, *Doing Away with Personal Injury Law: New Compensation Mechanisms for Consumers and Business* (Quorum Books, 1992); R Avraham and M Schanzlenbach, 'The Impact of Tort Reform on Private Health Insurance Coverage' *Northwestern University School of Law Public Law and Legal Theory Series, No. 07-16, 2007*.

<sup>95</sup> S Govindaraj, P Lee and D Tinkelman, 'Using the Event Study Methodology to measure the Social Costs of Litigation – a Re-Examination Using Cases from the Automotive Industry' (2007) 3(2) *Review of Law & Economics* 342.

<sup>96</sup> 84 F 3d 734 (5th Cir 1996).

<sup>97</sup> 51 F 3d 1293 (7th Cir 1995).

<sup>98</sup> See, eg, Linda S. Mullenix, *Abandoning the Federal Class Action Ship: Is There Smoother*

*Sailing for Class Actions in Gulf Water?*, (2000) 74 *Tulane Law Review* 1709 (arguing that 'many class counsel have abandoned the federal courts in favor of what are perceived to be more receptive state court forums').

<sup>99</sup> TE Willging and EG LEE III, 'From Class Actions to Multidistrict Consolidations: Aggregate Mass-Tort Litigation After *Ortiz*' (2010) 58(4) *Kansas Law Review* 775.

disaster were diverted from being made through the courts to a specially-established compensation fund,<sup>100</sup> as with the 2010 BP Gulf oil spill.<sup>101</sup>

### Insurance claims

The RAND Institute for Civil Justice survey of insurance companies led by Pace found that 89 per cent of reported insurance class actions in the period 1993 through 2002 were originally filed in state courts, which was not felt to be surprising, since insurance in the United States is regulated at the state level and presumably claims involving federal statutes would be relatively few in number.<sup>102</sup> The most common claim was that the insurer failed to compensate policyholders for the diminished value of automobiles following repairs under the insured's first-party coverage. About half of all cases involved allegations related to the payment of medical benefits to health care providers under automobile policies, various real and personal property coverage claims, claims by policyholders or beneficiaries under automobile uninsured or underinsured motorist policies, diminished value claims related to first party automobile coverage, or various workers' compensation issues.

The RAND insurance study found that only 14 percent of the cases in its data set wound up with certified classes. The judges denied certification in 11 percent of the cases, and the remainder (about 75 percent of the total) never had a decision either way. There were striking differences in final outcomes depending on the status of the motion for certification. For all attempted class actions in the RAND insurance study, a negotiated settlement that bound a certified class took place in only 12 percent of all closed cases. Settlements involving only the small number of plaintiffs specifically named in the original filings, and not a class, occurred in 20 percent of the cases. The judge ruled in favour of the defendant on some sort of dispositive pre-trial motion in 37 percent of the cases. In 27 percent of the cases, plaintiffs dismissed their complaints voluntarily, presumably without prejudice, which would have allowed them to re-file the same case later. For class actions in which the plaintiffs made a motion for certification, however, the distribution of outcomes changed considerably. Class settlement in those cases was much more likely, with a third of all cases resulting in a settlement for a certified class. The frequency with which plaintiffs voluntarily drop their cases is reduced, as are pre-trial dispositive rulings for the defence. When a class was, in fact, certified, the end result in nine of the 10 cases in the study was a class settlement.

### Antitrust cases

Private enforcement was mandated by the Sherman Act, which provided a right of action for any person 'injured in his business or property' by virtue of an antitrust violation to sue for 'threefold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee'. The US Antitrust Division believes 'individual accountability through imposition of jail sentences is the single greatest deterrent' to cartel activity.<sup>103</sup> A senior US public enforcer has said that a private enforcement system may in fact hinder, rather than help, the public authorities in their enforcement of competition laws.<sup>104</sup>

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<sup>100</sup> GK Hadfield, 'Framing Choice between Cash and the Courthouse; Experiences with the 9/11 Victim Compensation Fund' (2008) 42(3) *Law & Society Review* 645-82.

<sup>101</sup> L. S. Mullenix, 'Prometheus Unbound: The BP Gulf Coast Claims Facility as a Means for Resolving Mass Tort Litigation -- A Fund Too Far' (2011) 71(3) *Louisiana Law Review* 819.

<sup>102</sup> NM Pace, SJ Carroll, I Vogelsang and L Zakaras, *Insurance Class Actions in the United States* (RAND Institute for Civil Justice, 2007).

<sup>103</sup> SD Hammond, 'Ten Strategies for Winning the Fight Against Hardcore Cartels', Paper presented at Paris Working Party No 3 Prosecutors Program, Oct 18, 2005.

<sup>104</sup> JT Rosch, 'Does the EU Need a System of Private Competition Remedies to Supplement Public Law Enforcement?', speech at 2011 LIDC Congress, Christ Church, Oxford, 23 September 2011

DuVal's study of antitrust class actions between 1966 and 1973 from the court records of the Northern District of Illinois found that the contribution of the class action had enabled types of plaintiffs to sue who would otherwise have been unable to do so because of the size of their claims.<sup>105</sup> On the other hand, Ginsburg and Brennan argued that judicial resolution of antitrust cases in the 1960s created a 'plaintiff's picnic', with the courts construing the antitrust laws to protect firms from their competitors without regard to whether the defendant had caused any injury to the competitive process.<sup>106</sup> An explosion of cases after the war peaked in 1975-79, at which point private litigation exceeded public enforcement by a ratio of 20-1, and stabilised in the 2000s in the 9-1 range.<sup>107</sup> The private 'follow on' actions that used to be filed routinely have dwindled in number since the Supreme Court's decision in *Twombly*.<sup>108</sup>

Class members in DuVal's cohort obtained relief in less than one-third of terminated class actions, and one-third were dismissed without any settlement. Most class settlements fell far short of the aggregate damages sustained by the class. Antitrust class actions were burdensome because they were large, involving more parties and attorneys, greater discovery, and greater potential recovery.

The 'Georgetown Study' of 1985,<sup>109</sup> which examined some 1,900 cases filed in five US District Courts in 1973-83, found that the system included both bad cases and meritorious cases that would not have been brought by the government, whilst around 80 per cent of cases settled after 2 years, and of those that proceeded to trial the plaintiffs won less than 30 per cent. A quarter of private cases were follow-ons to public enforcement.

The threat of costly civil class action litigation initiated under federal and/or state laws has the potential to force settlement on extortionate terms, because if it is initiated under federal law, defendants face the prospect of joint and several liability without a right to contribution. Crane's review of the antitrust evidence concluded that cases were easy to bring, costly to defend, unlikely to be involuntarily dismissed by the courts, and hence likely to coerce the defendant to pay a substantial settlement to be rid of the case.<sup>110</sup> He argued that much private antitrust litigation was motivated by businesses seeking a strategic advantage in the marketplace rather than by publicly minded private attorneys general. Elzinga and Wood also concluded that many private antitrust lawsuits were strategically motivated.<sup>111</sup> Snyder and Kauper found evidence that the private antitrust remedy was often used to subvert, rather than promote, competition.<sup>112</sup>

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<sup>105</sup> BS DuVal, Jr, 'The Class Action as an Antitrust Enforcement Device: The Chicago Experience (I)', (1976) *American Bar Foundation Research Journal* 1021 ; BS DuVal, Jr, 'The Class Action as an Antitrust Enforcement Device: The Chicago Experience (II)' (1976) 1(4) *American Bar Foundation Research Journal* 1273-1358.

<sup>106</sup> DH Ginsburg & L Brannon, 'Determinants of Private Antitrust Enforcement in the United States' (2005) *Competition Policy International*, Autumn at 37.

<sup>107</sup> DA Crane, *The Institutional Structure of Antitrust Enforcement* (Oxford University Press, 2011). See also Sourcebook of Criminal Justice Statistics Online, <http://www.albany.edu/sourcebook/pdf/t5412007.pdf>. Antitrust cases filed in US District Courts 1975-2007, Table 5.41.2007 shows that the percentage of private to public cases has only fallen below 90% in 9 of the 32 years (mainly around 1990, lowest 83.4%) and since 2000 the trend has risen to 96.6% in 2007. See S Salop and L White, 'Private Anti-trust Litigation: An Introduction and Framework' in L White (ed), *Private Anti-trust Litigation: New Evidence, New Learning* (Cambridge, Mass., 1988) 3 and CA Jones, *Private Enforcement of Anti-trust Law in the EU, UK and USA* (Oxford, Oxford University Press, 1999).

<sup>108</sup> *Bell Atlantic Corp. v. Twombly*, 550 US 544 (2007).

<sup>109</sup> *Georgetown Study of Private Antitrust Litigation: Papers from the Georgetown Conference on Private Antitrust Litigation* (Airlie House, Virginia, 8-9 November 1985). Later versions of some papers are in L White (ed.), *Private Antitrust Litigation: New Evidence, New Learning* (Cambridge, Mass., MIT Press, 1988), 3.

<sup>110</sup> DA Crane, *The Institutional Structure of Antitrust Enforcement* (New York, Oxford University Press, 2011), 58.

<sup>111</sup> KG Elzinga and WC Wood, 'The Costs of the Legal System in Private Antitrust Enforcement' in LJ White (ed), *Private Antitrust Litigation: New Evidence, New Learning* (Cambridge, MA, MIT Press, 1988) 134.

<sup>112</sup> EA Snyder and TE Kauper, 'Misuses of the Antitrust Laws: The Competitor Plaintiff' (1991) 90 *Michigan Law Review* 551.

## Employment disputes

Employment claims (yearly average 29.3%) were the largest types in Heiman's study of 3,711 class actions filed between 2000 and 2005 in California.<sup>113</sup> A study of the class actions certified between 1979 and 1984 in the Northern District of California found that the clear majority were employment discrimination cases.<sup>114</sup> These were heavily dependent on obtaining initial information and analysis from the public authority, the Equal Employment Opportunity Commission (EEOC).<sup>115</sup> Several cases ended with a remedy that depended on governmental action to oversee it.

## Consumer actions

Amounts claimed by and paid to individual consumers in class actions are typically small. Hensler *et al.* found that estimated losses in their 1995-1996 consumer suits ranged from an average of \$3.83 to an average of \$4,550; in five of the six cases the average was probably less than \$1,000.<sup>116</sup> They also found that negotiated compensation amounts varied dramatically: total compensation offered ranged from just under \$1 million to over \$800 million. The percentage of the intended amount that is received can vary considerably, ranging from 20 cents to 90 cents per dollar spent: the larger the total sum, the greater the percentage paid out. Average payments to individual class members ranged from about \$6 to \$1,500 in consumer suits, compared with from about \$6,400 to \$100,000 in mass tort suits. In three cases, class members claimed one-third or less of the funds set aside. In the Willging *et al.* (1996) study, the largest median per-member award (not reduced for attorneys' fees) in the four federal districts studied was \$528 and the maximum award was \$5,331.<sup>117</sup>

Analysis of 15 small-stakes consumer class actions settlements against some of the largest banks in MDL claims consolidated in 2009 found that between 1% and 70% of class members received some compensation, ranging from \$13 to \$90, representing between 6% and 69% of average class member damages, being largely dependent on the underlying strength of the class' claims.<sup>118</sup> Class members who had to complete forms negotiated very high payments as percentages of claimed losses (over 90%), whereas those in automatic settlements had lower rates (37% to 75%).<sup>119</sup>

However, sums actually paid to consumers are often far less than the sums envisaged in the settlement. This is because although such class actions begin as opt-out classes, individual plaintiffs need to opt-in to claim their individual payment or coupon, and the opt-in rate can be low. This means that, firstly, attorneys' fee recovery ratio is higher than as it appeared when the settlement was agreed and fees were approved by the court, secondly, the sum paid by the defendant leaves an undistributed amount (perhaps dealt with by a cy pres payment), and thirdly, either deserving plaintiffs go uncompensated, or a question arises over whether the enterprise was worth the cost, assuming it had legal merit.

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<sup>113</sup> H Heiman, *Findings of the Study of California Class Action Litigation, 2000-2006* (Judicial Council of California, Administrative Office of the Courts, 2009).

<sup>114</sup> BG Garth, 'Power and Legal Artifice: The Federal Class Action' (1992) 26 *Law & Society Review* 237: of the 46 class action clusters, the breakdown was 21 employment discrimination; 5 securities regulation; 5 social security; 4 antitrust; 2 housing eviction and relocation; 2 jails and detention; and 7 other.

<sup>115</sup> B Garth, IH Nagel and SJ Plager, 'The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation' (1987-1988) 61 *Southern California Law Review* 353.

<sup>116</sup> DR Hensler, B Dombey-Moore, B Giddens, J Gross, EK Moller and NM Pace, *Class Action Dilemmas. Pursuing Public Goals for Private Gain* (RAND Institute for Civil Justice, 2000).

<sup>117</sup> TE Willging, LL Hooper and RJ Niemic, *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* (Washington, D.C., Federal Judicial Centre, 1996).

<sup>118</sup> BT Fitzpatrick and RC Gilbert, 'An Empirical Look at Compensation in Consumer Class Actions' (2015) *New York University Journal of Law & Business* (forthcoming).

<sup>119</sup> *ibid.*

Studies have found that there appear to be substantial variations in take up rates in relation to those who opt in to consumer class settlements. Hensler found rates varying from 30% to 100%,<sup>120</sup> with the result that far less was paid out to plaintiffs than had been agreed in settlements (see below). Pace confirmed the finding in the RAND insurance study, and noted reasons why individuals might not claim. In that study, total funds offered by the defendants to pay benefits to class members and the fees and expenses of class counsel were reported in 32 cases and ranged from \$360,000 to \$150,000,000 with a median fund size of \$2,600,000.<sup>121</sup> The common fund was less than \$5 million in 63 percent of the reported cases, a finding of interest in estimating CAFA's impact. In the 36 cases in which the respondent provided information on class size estimated at the time of settlement, the classes ranged from as small as 127 members to as large as 4,300,000 members, with a median of 28,000 members. However, the number of final recipients of funds appeared lower than that indicated from the settlement. A mean average total payout of \$9.5 million was made in 39 cases, but including a single case in which \$149 million was paid out. Distributions were typically much smaller, with a median total payout of \$500,000 and, in one case, the total was just \$200. In some instances, the total payout represented a fraction of the net compensation fund. The number of class members who ultimately received at least some direct monetary benefit was reported in 33 cases. In four of these cases, payments were made to fewer than 100 individuals or businesses. Although the mean number of recipients was 27,000 class members and the median size was 1,500 members, in one instance, only a single class member received any direct benefits at all. In contrast, there were 600,000 compensated class members in the largest reported case.

Pace and Rubenstein investigated distribution rates in interviews with judges, lawyers and administrators in 57 class actions, which produced usable information on 11 cases.<sup>122</sup> Three cases had distribution rates below 5%, two of which were below 1%; four cases had distribution rates between 20-40%; and two cases had distribution rates above 50%, one at 65% and one at 82%. The cases with the highest claiming rates had very small class sizes (a few hundred members). It was rare that a large class had a more than negligible distribution rate. The average claim per class member varied from a low of about \$10 to a high of about \$850,000 (in a big antitrust case). Claiming rates did not vary with the size of the claim. It appeared that claiming rates are apt to be lower the larger the class, higher the smaller the class. They concluded that it is very difficult to find distribution data.

The Hensler and Pace studies observed that opt in rates rise as the sums available increase, but rates may be noticeably low below say \$1,000: the 'it just ain't worth it' syndrome applies to opting into settlements as much as to initiating litigation and opting in to class actions. It has also been found that the number and percentage of opt outs may depend on the type of the claim: more opt out in mass tort to bring individual actions.<sup>123</sup> Accordingly, questions remain to be answered whether the opt out class mechanism is effective and economical, and in what circumstances.

The challenges that arise in distributing funds to a large class of individuals were illustrated by a 1976 study that the court ordered to be undertaken into the process of refunding overcharge for tetracycline antibiotics in 1975.<sup>124</sup> Interviews were held with 896 consumers who received refunds and 101 who had not because they failed to return evidence of purchase. The claims distribution process was

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<sup>120</sup> DR Hensler, B Dombey-Moore, B Giddens, J Gross, EK Moller and NM Pace, *Class Action Dilemmas. Pursuing Public Goals for Private Gain* (RAND Institute for Civil Justice, 2000).

<sup>121</sup> NM Pace, SJ Carroll, I Vogelsang and L Zakaras, *Insurance Class Actions in the United States* (RAND Institute for Civil Justice, 2007).

<sup>122</sup> NM Pace and WB Rubenstein, 'How Transparent are Class Action Outcomes?' Empirical Research on the Availability of Class Action Claims Data' Working Paper (RAND Institute for Civil Justice, 2008).

<sup>123</sup> T Eisenberg and GP Miller, 'Attorney Fees in Class Action Settlements: An Empirical Study' (2004) 1(1) *Journal of Empirical Legal Studies* 27-78. Those results were in accordance with Willging *et al.* 1996, above.

<sup>124</sup> TC Bartsh, FM Boddy, BF King and PN Thompson, *A Class-Action Suit That Worked. The Consumer Refund in the Antibiotic Antitrust Litigation* (Lexington MA, Lexington Books, 1978)

considered to have been a success, because it resulted in substantial reimbursement. Class members could not be identified individually, so the court had ordered a fund to be created, which included \$750,000 for future administrative expenses, from which there was a surplus that was used to fund the research. Nearly one million of three million affected consumers came forward and were compensated. The purchases had occurred some ten to twenty years previously. Over \$800,000 had been spent on postage in notifying potential claimants, but it was found that personal notice by mail was not an effective means of communication. Nearly one-half of claimants did not remember receiving mailed notices. Many of those who did remember receiving notification did not understand the messages. Newspapers were as effective in terms of impact on recollection as were mailed notices, and the cost of newspaper publicity was insignificant. Analysis of those who claimed suggested that it was easier to attract class action claimants to come forward from the responsible, informed and unalienated mainstream of society.

### **Costs**

Intermediaries' transactional costs are substantial in class actions. The courts usually base awards on a percentage of the total settlement amount, perhaps with a mean between 22-29%, with a range from 5% to 50%. In some consumer cases, lawyers receive more than the total received by class members. In economics terms, the system pays significant rents, and is highly inefficient. But the system of private enforcement is based on creating significant incentives for intermediaries.

As Hensler *et al.* pointed out in 2000, determination of whether the fees of attorneys or other service-providing intermediaries are reasonable is a political judgment, influenced by local social factors.<sup>125</sup> She argued that the issue is not how class counsel fees compare to payments to individual class members, but rather how the fees compare to the 'common benefit' produced by the class action attorneys' efforts. The more fundamental point, however, is that the US system seeks positively to create two goals: first, sufficiently attractive incentives to encourage intermediaries to assume risk (and to insulate representative plaintiffs from any risk) and, second, imposition of large penalties that will have a deterrent effect on corporate behaviour, thereby acting as regulation.

### Attorneys' fee awards

In their study of ten federal and state consumer and mass tort class actions, Hensler *et al.* found that class action attorneys received substantial fees in all successful suits.<sup>126</sup> Awards to class action attorneys ranged from about half a million dollars to \$75 million. It was calculated that average hourly fees ranged from \$320 to almost \$2,000. Transaction costs, excluding defendants' legal fees and expenses, were lowest in three of the four mass tort class actions studied, and highest in the six consumer class actions. In the nine known cases studied, class counsel fee-and-expense awards ranged from 5% to about 50% of the total settlement value, which the researchers regarded as a modest share of the negotiated settlements. In eight of the nine cases, class counsel received one-third or less of the total settlement value. Class counsel received one-third or less of the actual settlement value in six of the ten cases; in the remaining four cases, class counsel's share of the actual settlement value was about one-half. In three of the mass tort cases, class counsel were awarded less than 10% of the actual settlement value, but the absolute dollar amount of fees was very large, because these settlements were huge. In three of ten cases studied in detail, class counsel received more than the total received by class members altogether.

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<sup>125</sup> DR Hensler, B Dombey-Moore, B Giddens, J Gross, EK Moller and NM Pace, *Class Action Dilemmas. Pursuing Public Goals for Private Gain* (RAND Institute for Civil Justice, 2000).

<sup>126</sup> DR Hensler, B Dombey-Moore, B Giddens, J Gross, EK Moller and NM Pace, *Class Action Dilemmas. Pursuing Public Goals for Private Gain* (RAND Institute for Civil Justice, 2000).

Put another way, transaction costs accounted for about half or more of defendants' expenditures (excluding their own fees) in four of ten class actions, and about one-quarter or less in another four suits; for about one-third in the remaining two suits. Data was available on the total amounts paid by defendants in three cases, in which plaintiff attorneys' fees and expenses accounted for 50-60% of the transaction costs that defendants paid.

Hensler *et al.* commented that the reason why successful actions may yield enormous fees for attorneys is because fees are usually calculated as a percentage of the total dollars paid by defendants. The financial incentives that damage class actions provide to private attorneys tended to drive the frequency and variety of class action litigation upwards. In mass tort cases, there were increased numbers of legal representatives in a case, driving up total transactional costs and leading to enormous financial stakes. Class action specialists were found to have developed extensive monitoring strategies to improve their ability to detect situations that seem to offer attractive grounds for litigation.

In contrast, those researchers found that most consumer class members have only a small financial stake in the litigation. Few if any consumer class members actively monitored the class action attorney's behaviour. Such 'clientless' litigation held within itself the seeds for questionable practices. The powerful financial incentives that drive plaintiff attorneys to assume the risk of litigation intersect with powerful interests on the defence side in settling litigation as early and as cheaply as possible, with the least publicity. These incentives can produce settlements that are arrived at without adequate investigation of facts and law and that create little value for class members or society. For class counsel, the rewards and fees are disproportionate to the effort they actually invested in the case. Kalajdic raised similar issues for Canada.<sup>127</sup>

Eisenberg and Miller's (2004) study of court-approved class actions in 1993-2002 found a scaling effect existed, with the amount of client recovery being overwhelmingly the most important determinant of the attorney fee award.<sup>128</sup> While the absolute size of the fee increased as the size of the recovery increased, fees as a percentage of the recovery decreased. The mean fee award in common fund cases (i.e. where a common settlement fund was created) was 21.9% of the recovery across all cases. Higher fees were associated with higher risk, and low-risk cases generated lower fees. The presence of 'soft relief' (injunctions or coupons) had no material effect on the fee. Class counsel dominated and controlled the litigation. In non-fee-shifting cases, very few awards exceeded 35% of client recovery. In fee-shifting cases, there was a much wider distribution of fee awards. However, as discussed above, Eisenberg and Miller's figures record gross amounts reported for the value of settlements, and account needs to be taken of sums actually paid out from common funds, which may be lower, and would mean that attorneys' fee recovery ratios would be correspondingly higher in such cases.

One of the data sources used by Eisenberg and Miller was a study by Logan, Moshman and Moore (2003) of 1,200 cases collected by Class Action Reports, from which the authors estimated that the average fee rate was 18.4 percent across all types of claims, but was just over 30 percent if the fund size was under \$10 million.

Powerful confirmation of the findings of the 2004 study were published in a follow-up study in 2010.<sup>129</sup> The data set by then covered 18 years of published judicial opinions from 1993 to 2008 inclusive on settlements in class action and shareholder derivative cases in both state and federal courts. They found that the overwhelmingly important determinant of the class attorneys' fee was

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<sup>127</sup> J Kalajdic, *Access to Justice for the Masses? A Critical Analysis of Class Actions in Ontario*, Master of Laws thesis, University of Toronto, (2009).

<sup>128</sup> T Eisenberg and GP Miller, 'Attorney Fees in Class Action Settlements: An Empirical Study' (2004) 1(1) *Journal of Empirical Legal Studies* 27-78.

<sup>129</sup> T Eisenberg and G P Miller, 'Attorneys' Fees and Expenses in Class Action Settlements: 1993-2008' (2010) 7(1) *Journal of Empirical Legal Studies* 248-81.

simply the size of the class recovery obtained by the class. There was a strikingly strong linear relationship between fee awards and recoveries. There was no robust evidence of differences between state and federal courts. Courts granted the fee requested by attorneys in over 70% of the cases, and there were strong differences in the grant rate between Circuits. In cases where the requested fee was not awarded, the mean fee was 68% of the requested amount. Fees and costs exhibited scale effects with the percent of each decreasing as the class recovery amount increased. Fees were not significantly affected by the existence of a settlement class, the presence of objectors, or opt-outs from the class. Costs and expenses were strongly associated with hours expended on the case. Costs were modest, with both mean and median costs comprising less than 3% of the class recovery. Mean fees ranged from 11% of the class recovery in tax cases to 27% in employment cases. In the larger case categories fees to recoveries ranged from 21% to 27% of recoveries.

Eisenberg, Miller and Perion noted that the Second Circuit Court of Appeals in *Goldberger* in 2000<sup>130</sup> had mandated strict scrutiny by trial court judges of attorneys' fee applications in class actions. They carried out a regression analysis of 717 settlements in federal securities class actions filed from 1984 through 2005 and settled from 1991 through 2007 to check judges' actual behaviour.<sup>131</sup> They found that, firstly, fees demanded and received were no lower than earlier, or fees in other circuits, secondly, the *Goldberger* decision had produced an impact on fee-setting practices. As settlement size increased, both fee requests and fee awards rose at a slower rate in the cases subject to *Goldberger*, while judicial scrutiny increased. They suggested that the finding supported the proposition that compliance was tied to the probability of appeal and reversal.

Pace *et al.* obtained information on awards to class counsel for fees and expenses in 48 insurance class actions. The awards ranged from \$50,000 to \$50,000,000 with a median award of \$554,000.<sup>132</sup> They calculated an approximate fee and expense percentage for 27 cases, which ranged from 12 to 41 percent of the fund, with a mean of 29 percent and a median of 30 percent. However, the 'effective' fee and expense percentages—in other words, those based on the fee and cost awards divided by the sum of the distributed benefits, attorneys' fees, and other costs—increased to a median average of 47 percent (based on 36 cases in which this information was available). In a quarter of these cases, the effective fee and cost percentages were 75 percent or higher and, in 14 percent (five cases), the effective percentages were over 90 percent.

A 2010 study of 40 successful, large-scale private antitrust cases involving automotive companies<sup>133</sup> confirmed that the courts awarded class counsel a percentage of the recovery that was usually 30% or 33.3% for (17) cases involving recoveries under \$100 million (albeit only 7% in one case, generating \$4.55 million). For recoveries over that sum and below \$500 million, the awards (8 cases) ranged between 20% and 33.3%, and for recoveries over \$500 million (5 cases) the range was between 5.2% and 33.3%. The relevance lies less in the percentages than in the amounts, which were not given in the study: a third of \$50 million is \$16.65 million, and 6.5% of the largest recovery of \$3,383 million is \$219.90 million.

Fitzpatrick's study of all 2006-2007 federal class settlements<sup>134</sup> found that judges awarded nearly \$5 billion in fees and expenses to class action lawyers in those two years: 13 % of the settlement amount

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<sup>130</sup> 209 F.3d 43, 45 (2d Cir. 2000).

<sup>131</sup> T Eisenberg, GP Miller and MA Perino, 'A New Look at Judicial Impact: Attorneys' Fees in Securities Class Actions after *Goldberger v. Integrated Resources, Inc.*' (2009) 29 *Washington University Journal of Law and Policy* 5.

<sup>132</sup> NM Pace, SJ Carroll, I Vogelsang and L Zakaras, *Insurance Class Actions in the United States* (RAND Institute for Civil Justice, 2007).

<sup>133</sup> S Govindaraj, P Lee and D Tinkelman, 'Using the Event Study Methodology to measure the Social Costs of Litigation – a Re-Examination Using Cases from the Automotive Industry' (2007) 3(2) *Review of Law & Economics* 342.

<sup>134</sup> BT Fitzpatrick, 'An Empirical Study of Class Action Settlements and their Fee Awards' (2010) 7(4) *Journal of Empirical Legal Studies* 811–846.

in 2006 and 20% in 2007. Interestingly, those percentages are far lower than the portions of settlements that contingency fee lawyers receive in individual litigation, which are usually at least 33%. Fitzpatrick's figures are fairly consistent with the Eisenberg-Miller data from 2003 to 2008.

Fitzpatrick found that judges awarded fees over a broad range, from 3% to 47% of the settlement sum (average 25.4%, median 25%). Most fee awards were between 25% and 35%. (Eisenberg and Miller's mean was 24%, and median 25%.) Fee percentages did not differ greatly across litigation subject areas, with most mean and median awards between 25% and 30%. In the most oversubscribed Circuits, Second and Ninth, mean fee awards were *under* 25%. He found no evidence of political bias amongst judges in relation to fee awards.

Fitzpatrick repeated the finding that fee percentages are strongly and inversely related to the size of the settlement both in securities fraud and other cases. In his data, fee percentages tended to drift lower at a fairly slow pace until a settlement size of \$100 million was reached, at which point the fee percentages plunged well below 20%, and by the time \$500 million was reached, they plunged well below 15%, with most awards at that level under even 10%.

One response to attorney fee issues has been for some judges to auction appointment as class counsel, so as to adopt a market mechanism to identify lowest prices. Hooper and Leary's review of 14 such class counsel auctions concluded that attorneys' fees were generally less than the reported percentages in other class actions in the respective circuits.<sup>135</sup> The majority of fee awards was less than 9% (but this may or may not include expenses) of the total recovery, and ranged from a low of approximately 5% to a high of 22.5%.

A small number of cases are reported in which private bodies have objected to fees,<sup>136</sup> but it appears that few if any class members object to fees or settlements.

#### Damages ultimately paid

Illustration of the large potential size of aggregate outcomes in class actions can be seen from Eisenberg and Miller's 2004 finding that the average class action recovery in the cases studied was \$138.6 million and aggregate class action recoveries averaged \$5.13 billion per year.<sup>137</sup> The average recovery of the top 20% of their cases was \$613 million, and the average for the top 10% of cases was \$1.08 billion. The gross recovery across Eisenberg and Miller's 370 cases (in 2002 \$) had a mean of \$100 million and median of \$11.6 million. In the four federal districts studied in the Class Action Reports set of cases the mean recovery was \$35.4 million, and median \$7.6 million.<sup>138</sup> The mean recovery did not noticeably increase over the decade studied. The median level of individual recoveries ranged from \$315 to \$528 and the maximum awards ranged from \$1,505 to \$5,331 per class member.

Fitzpatrick found that the vast majority of federal class action settlements in 2006 and 2007 provided cash relief (82 per cent), but a substantial number provided injunctive or declaratory relief (23%) or

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<sup>135</sup> LL Hooper and M Leary, *Auctioning the Role of Class Counsel in Class Action Cases: A Descriptive Study* (Federal Judicial Centre, 2001). Of the cases, 12 were securities and 2 antitrust; 8 had terminated and all of them settled. The number of bids ranged from 2 to 21, average 7, median 8.

<sup>136</sup> TF Burke, *Lawyers, Lawsuits, and Legal Rights. The Battle over Litigation in American Society* (University of California Press, 2002)

<sup>137</sup> T Eisenberg and GP Miller, 'Attorney Fees in Class Action Settlements: An Empirical Study' (2004) 1(1) *Journal of Empirical Legal Studies* 27-78.

<sup>138</sup> TE Willging, LL Hooper and RJ Niemic, *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* (Washington, D.C., Federal Judicial Centre, 1996).

in-kind relief (6%).<sup>139</sup> Every single securities settlement provided cash to the class and almost none of them provided in-kind, injunctive, or declaratory relief. Consumer cases had the greatest percentage of settlements providing for in-kind relief (30%), reflecting the CAFA debate. Civil rights cases had the greatest percentage of settlements providing for injunctive or declaratory relief (75%), though almost half of civil rights cases also provided some cash relief (49%).

Fitzpatrick noted that the settlements transferred a total of over \$22 billion in 2006 and over \$11 billion in 2007, although the figures were influenced by large individual cases: the 2006 figures included \$6.6 billion for Enron and seven of the eight 2006-2007 settlements for more than \$1 billion. Thus, a mere 1 per cent of the settlements comprised over 50 per cent of the wealth transferred in federal class action settlements in 2006 and 2007. Nearly two-thirds of all settlements fell below \$10 million. Securities settlements comprised around three-quarters of all the money in the settlements. The distribution of what defendants agreed to pay in settlements is shown in Table 2.

Table 2. The total amount of money involved in federal class action settlements in 2006 and 2007

Subject matter	Total ascertainable monetary value in settlements (and percentage of overall annual total)			
	2006 (n=304)		2007 (n=384)	
Securities	\$16,728,064,453	76%	\$8,037,685,000	73%
Labor and Employment	\$266,539,879	1%	\$547,674,587	5%
Consumer	\$517,293,758	2%	\$732,781,271	7%
Employee Benefits	\$443,818,414	2%	\$280,765,005	3%
Civil Rights	\$265,389,085	1%	\$81,654,501	1%
Debt Collection	\$8,942,686	<1%	\$5,743,758	<1%
Antitrust	\$1,078,595,316	5%	\$660,485,846	6%
Commercial	\$1,216,943,020	6%	\$124,046,570	1%
Other	\$1,567,759,101	7%	\$592,524,150	5%
Total	\$22,093,345,712	100%	\$11,063,360,688	100%

The distribution by size of the 2006-2007 federal class action settlements that had ascertainable value is shown in Table 3.

Table 3. Distribution by size of federal class action settlements 2006-2007

Settlement size (in millions)	Number of settlements	Percentage
[\$0 to \$1]	131	21.7%
(\$1 to \$10]	261	43.1%
(\$10 to \$50]	139	23%
(\$50 to \$100]	33	5.45%
(\$100 to \$500]	31	5.12%
(\$500 to \$6600]	10	1.65%
Total	605	

<sup>139</sup> BT Fitzpatrick, 'An Empirical Study of Class Action Settlements and their Fee Awards' (2010) 7(4) *Journal of Empirical Legal Studies* 811-846.

The average settlement over the entire two-year period for all types of cases was almost \$55 million, but the median was only \$5.1 million: see Table 4. (With the \$6.6 billion Enron settlement excluded, the average settlement for all ascertainable cases dropped to \$43.8 million, and, for securities cases, dropped to \$71.0 million.) The average settlements varied widely by litigation area, with securities and commercial settlements at the high end of around \$100 million, but the median settlements for nearly every area were bunched around a few million dollars. It should be noted that the high average for commercial cases is largely due to one settlement above \$1 billion; when that settlement is removed, the average for commercial cases was only \$24.2 million.

Table 4. The average and median settlement amounts in the 2006-2007 federal class action settlements with ascertainable value to the class

Subject matter	Number	Average	Median
Securities	257	\$96,364,783	\$8,000,000
Labor and Employment	88	\$9,243,855	\$1,797,625
Consumer	65	\$18,834,741	\$2,898,051
Employee Benefits	52	\$13,873,262	\$5,318,500
Civil Rights	34	\$9,690,141	\$2,500,000
Debt Collection	40	\$366,498	\$88,000
Antitrust	29	\$59,951,074	\$22,000,000
Commercial	12	\$111,736,382	\$7,125,000
Other	28	\$76,612,319	\$6,152,000
All	605	\$54,700,105	\$5,107,607

The \$16 billion transferred annually in these cases is roughly 10% of the \$160 billion and \$164 billion for all American tort claims recorded in the annual Tillinghast-Towers Perrin survey. That is a significant amount of money in so few cases (350).

Analysis of 127 resolved class action suits filed in, or removed to, federal court in 2009, resolved by 1 September 2013, and referred to in two leading reporter journals found that 41 (31%) had been dismissed on the merits by court (dismissal on the pleadings or grant of summary judgment for the defendant, 45 (35%) had been dismissed voluntarily or settled individually with the lead plaintiff, without any relief for other class members, and 40 (33%) had been settled as a class.<sup>140</sup> Thus, in nearly two-thirds of resolved cases in this set, class members received nothing.

#### Economic costs

Figures are available for total tort costs: the distinction between tort and the types of cases enforced through class actions should be noted. Over the past 50 years, direct tort costs in the US grew more than 100-fold from less than \$2 billion in 1950 to \$254.7 billion in 2008, exceeding Gross Domestic Product (GDP) growth by an average of over two percentage points.<sup>141</sup> The authors estimated that in 2008 personal tort costs were \$94.2 per person and business tort costs were \$160.5. ‘Commercial’ reflected torts alleged against businesses and included all medical malpractice tort costs. ‘Personal’

<sup>140</sup> *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Mayer Brown LLP, 2013), at <https://www.mayerbrown.com/files/uploads/Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf>. The publications from which the data set was assembled were *The BNA Class Action Litigation Reporter* and *Mealey’s Litigation Class Action Reporter*.

<sup>141</sup> *2009 Update on US Tort Costs Trends* (Towers Perrin, 2009).

tort costs included torts alleged against individuals, excluding medical malpractice. Personal tort costs stemmed from automobile accidents.

The 2006 figure equated to a 'litigation tax' of \$825 per person, compared to \$12 in 1950. In 2009 total tort costs were equal to 1.79% of the GDP of the United States: that percentage fell since a high of 2.24% in 2003. In 2006 nearly one in six jury awards were \$1 million or more, and over 7% of businesses experienced a liability loss of \$5 million or more during the previous five years.<sup>142</sup>

In 2005 the annual tort cost for small United States businesses was \$98 billion. This equated to \$20 per £1,000 of revenue. Small businesses bore 69% of US business tort liability but took only 19% of revenues. They paid \$20 billion of their tort costs out of pocket, as opposed to through insurance.<sup>143</sup>

Some sources allege that the full cost of the US system is \$865.37 billion, which is equivalent to an 8 percent tax on consumption, or a 13 percent tax on wages.<sup>144</sup> There has been strong criticism of these figures<sup>145</sup> but, whatever the true figures may be,<sup>146</sup> the cost of the US civil justice system is clearly high and is argued by industry to constitute an unnecessary and debilitation tax on business and the economy, with disproportionately little benefit to competition, consumers or the economy.<sup>147</sup>

In 2006, 40% of the largest companies spent \$5m or more on litigation, excluding settlements and awards.<sup>148</sup> A 2009 poll of top American business lawyers found that 97 per cent consider that the American civil justice system is 'too expensive'.<sup>149</sup> A survey of 500 US Chief Executives by the Conference Board found that lawsuits caused 36% of their companies to discontinue products, 15% to lay off workers, and 8% to close plants.<sup>150</sup> A Gallup survey of US small businesses found that 26% of owners said that fear of liability kept them from releasing new products, services or operations to the market.<sup>151</sup> Over 200 insurance companies failed in the United States in the decade prior to 2006.<sup>152</sup>

A United States federal government analysis in 2002 concluded that excessive tort litigation costs in 2000 were an \$87 billion drag on the national economy.<sup>153</sup> The study estimated that the impact of wasteful legal expenditures equated to a 1.3% tax on consumption, or a 2.1% tax on wages. High

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<sup>142</sup> *US Tort Costs and Cross-Border Perspectives; 2005 Update* (Towers Perrin-Tillinghast, 2006).

<sup>143</sup> *Tort Liability Costs For Small Business* (US Chamber Institute for Legal Reform, 2007). Small businesses are defined here as those with less than £10 million annual revenues and at least one employee in addition to the owner. The tort cost increased 13% from 2002 to 2005.

<sup>144</sup> *Jackpot Justice: The True Cost of America's Tort System* (*Pacific Research Institute, 2007*). *The authors calculated that the excess (i.e. unnecessary) annual social cost in 2006 was \$588.63 billion, and the excess annual accounting cost is \$664.15 billion. They also asserted that the annual wealth loss to US stockholders is \$684 billion; 60,000 workers have been displaced through asbestos bankruptcies, at an economic cost of \$226million in 2006 \$s; each worker losing up to \$50,000 over his career. Human capital losses total up to \$3.16 billion in lost wages, and \$559 million capital lost to pensions.*

<sup>145</sup> See R. Posner at [http://www.becker-posner-blog.com/archives/2007/04/is\\_the\\_tort\\_sys.html](http://www.becker-posner-blog.com/archives/2007/04/is_the_tort_sys.html).

<sup>146</sup> See the overview by C. Silver, 'Does Civil Litigation Cost Too Much?' (2002) 80 *Texas Law Review* 2073.

<sup>147</sup> The state of Mississippi, for example, passed reform legislation in 2003, after which levels of claims fell, industry started to reinvest, employment levels rose, and doctors returned to practice in the state. See C. Ross, 'Jackson Action: In Mississippi Tort Reform Works' *The Wall Street Journal*, 15 September 2005.

<sup>148</sup> *Fourth Annual Litigation Trends Survey Findings* (New York, Fulbright & Jaworski, 2007).

<sup>149</sup> *Civil Litigation Survey of Chief Legal Officers and General Counsel belonging to the Association of Corporate Counsel*, (Denver: Institute for the Advancement of the American Legal System, 2010).

<sup>150</sup> US Senate Commerce Committee Report on Product Liability Reform Act of 1997.

<sup>151</sup> National Small Business Poll (National Federation of Independent Businesses, 2002).

<sup>152</sup> AM Best, 'Rising Number of P/C Company Impairments Continues Trend' March 10, 2003, quoted in D Deal *et al.*, *Tort Excess 2005: The Necessity for Reform from a Policy, Legal and Risk Management Perspective* (U S Chamber of Commerce, 2005).

<sup>153</sup> *An Economic Analysis of the U.S. Tort Liability System*, (U.S. Council of Economic Advisers, 2002).

litigation risks and stringent regulations were the principal factors in a 2007 Report that New York is in danger of losing its status as world financial centre.<sup>154</sup>

It has been asserted that 19% of tort costs go to claimant lawyers and the total in the early 2000s was almost \$40 billion a year, which was 50% more than Microsoft or Intel and twice that of Coca-Cola, so the combined cost would be somewhat more than that.<sup>155</sup>

In contrast to the United States' tort costs, European tort costs as a percentage of GDP in 2003 were said to be 0.6% in Poland and Denmark, 0.7% in France and UK, 1.1% in Germany and 1.7% in Italy.<sup>156</sup> However, one should be careful to make the right comparisons. If the US litigation system is intended to include a significant element of public enforcement, then it is illogical to compare the total costs of litigation or tort in USA (i.e. damages and transactional costs) with the costs of litigation in other jurisdictions. It would be more relevant to compare, firstly, the total costs of public and private enforcement of different jurisdictions and, secondly, the ratio of public to private enforcement costs.

### *Merits*

A key point is to be able to assess the merits of individual cases and thus conclude whether they are justified, or whether settlements have been reached at levels that were justifiable. There is almost no data that would establish whether cases or settlements have good or poor merits. So the extent to which the system provides just results or effective individual or general deterrence is unproven (and has been a highly contentious issue). Although courts approve settlements and fee proposals by plaintiff attorneys, it is extremely rare for courts to question the merits of settlements, or reject them.

Pace and Rubenstein addressed the issue of the transparency of outcomes in 2008.<sup>157</sup> A sample of 31 federal class action settlements confirmed that the distribution of benefits to class members in at least some cases fell far short of the ideal. A very small number of state courts made an attempt to track class actions to any degree. The researchers suggested that 13 of the 25 settlements appeared to be ones where there was arguably a need for the court to keep a close watch on the distribution of benefits.

Hensler *et al.*'s conclusion was that benefits and costs are very difficult to assess. They concluded that their enquiry into whether cases involved principled outcomes, in which individual compensation and deterrence were related to quantified approaches, proved inconclusive. Instead, they found that the process of reaching these outcomes suggests that class counsel were sometimes simply interested in finding a settlement price that the defendants would agree to, rather than in finding out what class members had lost, what defendants had gained, how likely it was that defendants would actually be held liable if the suit were to go to trial, and negotiating a fair settlement based on the answers to these questions. They commented that such instances undermine the social utility of class actions, which depends on how effectively the lawsuits compensate injured consumers and – many would argue – deter wrongful practices. Moreover, among the class actions studied, some settlements appeared at first reading to provide more for class members and consumers than they actually did, and class action attorneys' financial rewards sometimes were based on the settlements' nominal value rather than on the actual payout in the cases.<sup>158</sup> The authors commented that such outcomes contribute to public

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<sup>154</sup> MR Bloomberg and CE Schumer, *Sustaining New York's and the US's Global Financial Services Leadership*, 2007. Significantly, the authors were political opponents.

<sup>155</sup> *Trial Lawyers, Inc.* (Centre for Legal Policy, Manhattan Institute, 2003) at <http://www.triallawyersinc.com>.

<sup>156</sup> *US Tort Costs and Cross-Border Perspectives; 2005 Update* (Towers Perrin-Tillinghast, 2006). The data in this analysis was obtained from the insurance industry, but the basis for these European figures is not transparent.

<sup>157</sup> NM Pace and WB Rubenstein, 'How Transparent are Class Action Outcomes?' Empirical Research on the Availability of Class Action Claims Data' Working Paper (RAND Institute for Civil Justice, 2008).

<sup>158</sup> The position may subsequently have been affected by the Class Action Fairness Act of 2005.

cynicism about the actual goals of class actions for damages in contrast to the aspirations of class action advocates.

Various studies have examined settlements. In five large case studies of settlements, Tidmarsh<sup>159</sup> found that no two are alike. Several studies considered the issue of whether merits matter in settlements, or whether the private enforcement technique of a class action merely attracts attorneys to claim against companies over a threshold size with cases then being settled favourably to the claimants irrespective of the underlying merits (see Alexander 1991<sup>160</sup> and Cox *et al.* 2008,<sup>161</sup> both examining securities cases). Cox *et al.* found that since PSLRA was enacted, institutions are more likely to intervene in cases with larger estimated provable losses, and against firms with greater total assets, and where the SEC has previously taken enforcement action. They expressed disquiet at finding that 20.5 per cent of the settlements in their cohort were below \$2 million, and those cases involved shorter class action periods, significantly lower provable losses and quicker settlements than the norm, and yielded investors lower recovery on their provable losses than in larger settlements. Such cases indicated characteristics of “strike suits” i.e. opportunistic claims that raised concerns over merits.

The issues of how collective processes transform both claimants and their lawyers are being studied by Meili.<sup>162</sup> Studies on dispute transformation<sup>163</sup> of individual cases have found that lawyers shape their clients’ expectations and goals to what is realistically attainable within the legal system, often to only recovering money. Meili has found that in consumer class actions, rather than *deflating* the unrealistic expectations of clients in individual cases, lawyers deliberately *inflate* the expectations of their clients, encouraging them to look beyond individual monetary compensation and focus on relief of the entire class. If their clients refuse to be so encouraged, the lawyers do not adopt them as named plaintiffs. Named plaintiffs who give a deposition are given an incentive award ranging between \$500 and a few thousand dollars. Class lawyers felt that the process has been unfairly maligned, and attributed negative public perception to lawyers in securities and mass torts. Most were proud of their work, whilst a few attorneys were cynical about the potential of class actions to bring about any kind of meaningful social change. It appeared that representative claimants evidenced wider motivations than class action attorneys in relation to issues of enforcement.

### **Forum shopping**

It has been noted above that concerns over bias in state courts was one consideration that motivated the shift of securities cases to federal courts under the 1995 PSLRA. The same concern arose in relation to other claims. Hensler *et al.* found evidence of patterns of “shopping” for judges who would be more favourable to class actions in their 1995 and 1996 cases, with nearly 60% of reported class action decisions in state courts, especially in consumer, citizens’ rights and tort cases.<sup>164</sup> The 2007 RAND study of insurance class actions also found clustering, with two jurisdictions in particular (Miami-Dade County, Florida, and Cook County, Illinois) accounting for about 17 % of their state

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<sup>159</sup> J Tidmarsh, *Mass Tort Settlement Class Actions: Five Case Studies*, (Washington, DC, Federal Judicial Centre, 1998).

<sup>160</sup> JC Alexander, ‘Do the Merits Matter? A Study of Settlements in Securities Class Actions’ (1991) 43(3) *Stanford Law Review* 497-598.

<sup>161</sup> JD Cox, RS Thomas, L Bai, ‘There Are Plaintiffs and ... There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements,’ (2008) 61(2) *Vanderbilt Law Review* 355-386.

<sup>162</sup> S Meili, ‘Perceptions of Consumer Class Actions: The Views of Plaintiffs’ Lawyers and their Clients’, unpublished, February 2010.

<sup>163</sup> T Relis, ‘It’s Not About the Money!: A Theory on Misconceptions of Plaintiffs’ Litigation Aims’ (2007) 68 *University of Pittsburgh Law Review* 341-385.

<sup>164</sup> DR Hensler, B Dombey-Moore, B Giddens, J Gross, EK Moller and NM Pace, *Class Action Dilemmas. Pursuing Public Goals for Private Gain* (RAND Institute for Civil Justice, 2000).

cases.<sup>165</sup> Beisner and Miller noted evidence of a disproportionately high volume of class action filings in three other counties, where the annual filings increased substantially between 1998 and 2000.<sup>166</sup> A study of 2,816 commercial contracts (mainly credit and security agreements) found that jury trial was only waived in 20 per cent of them generally, but in 80 percent of those that designated Illinois as the forum.<sup>167</sup> At federal level, Fitzpatrick found that the class action settlements that were approved in 2006 and 2007 in the First, Second, Seventh, and Ninth (federal) Circuits constituted a much larger share than the share of all civil litigation that those Circuits resolved.<sup>168</sup> Fitzpatrick attributed the reasons for these data to lie in the fact that there were many securities cases in the financial districts of Boston and New York, and large corporate presence also in Chicago and San Francisco. Eisenberg and Miller found the same heavy concentration of federal class actions in their study of opinions delivered between 1993 and 2008.<sup>169</sup> They found that of the 95 federal district courts, more than half of all class actions in their data set occurred in five courts, which they noted also tended to be ones with large populations. The Southern District of New York accounted for 28% of the securities cases. The Eastern District of Pennsylvania led in antitrust and consumer cases. The Northern and Eastern Districts of California were leaders in employment cases.

A general shift of cases to federal courts occurred under the Class Action Fairness Act of 2005 (CAFA). However, a 2005 study for the Federal Judicial Center lent little support to the view that state and federal courts differed greatly in how they resolve class actions.<sup>170</sup> It found that state and federal courts were equally unlikely to certify cases filed as class actions. Both state and federal courts certified classes in fewer than one in four cases filed as class actions. Although state courts approved settlements awarding more money to the class than did federal courts, that difference was a product of the size of the class; individual class members on average were awarded more from settlements in federal courts than in state courts.<sup>171</sup>

A further 2007 study of eighty-eight districts for the Federal Judicial Centre by Willging and Lee III estimated that an average of 5,300 class actions per year were filed in federal courts from July 2001 through June 2006 (including original filings and removals from state courts), excluding class actions brought by *pro se* litigants, those involving prison conditions or habeas corpus claims, or where the United States government was a plaintiff.<sup>172</sup> They found a 46% increase in class action activity in the study districts as a whole in the six-month period January through June 2006, compared to the first six months of the study period, July through December 2001. Much of that increase was in cases involving federal law, especially labour class actions. In the sixteen months since CAFA went into effect on February 18, 2005, however, they found a substantial increase in class action activity based on diversity of citizenship jurisdiction, mainly relating to state-law contract and fraud claims (doubled

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<sup>165</sup> NM Pace, SJ Carroll, I Vogelsang and L Zakaras, *Insurance Class Actions in the United States* (RAND Institute for Civil Justice, 2007).

<sup>166</sup> JH Beisner and J Davidson Miller, *They're Making a Federal Case Out of It ... In State Court* (Civil Justice Report, 2001).

<sup>167</sup> T Eisenberg & GP Miller, 'Do Juries Add Value?: Evidence from an Empirical Study of Jury Trial Waiver Clauses in Large Corporation Contracts' (2007) 4(3) *Journal of Empirical Legal Studies* 539–588.

<sup>168</sup> BT Fitzpatrick, 'An Empirical Study of Class Action Settlements and their Fee Awards' (2010) 7(4) *Journal of Empirical Legal Studies* 811–846.

<sup>169</sup> T Eisenberg and G P Miller, 'Attorneys' Fees and Expenses in Class Action Settlements: 1993–2008' (2010) 7(1) *Journal of Empirical Legal Studies* 248–81.

<sup>170</sup> TE Willging and SR Wheatman, *An Empirical Examination of Attorneys' Choice of Forum in Class Action Litigation* (Washington, D.C., Federal Judicial Center, 2005).

<sup>171</sup> The median recovery was \$850,000 in state court and \$300,000 in federal court; class size was 5,000 members and 1,000 respectively, and typical recovery per class member was \$350 in cases remanded to state court and \$517 in federal court.

<sup>172</sup> TE Willging, and EG Lee III, *The Impact of the Class Action Fairness Act of 2005: Third Interim Report to the Judicial Conference Advisory Committee on Civil Rules* (Washington, D.C., Federal Judicial Centre, 2007).

and tripled respectively), plus a doubling of property damage cases, although tort and personal injury class actions in the federal courts had not greatly increased.

### ***Financial incentives, conflicts of interest, and abuse***

A system designed to deliver widespread *general* deterrence through an *ex post facto* mechanism involving mass non-specialist enforcers should logically aim at facilitating the achievement of results that have high impact on the market at large, possibly at the expense of fairness in individual cases. The hurdle of certification by the courts provides some form of fairness filter for cases. However, the criteria for certification do not, perhaps surprisingly, include a review of the merits of a case.<sup>173</sup>

The ‘private attorney general’ concept is thoroughly embedded in the United States legal system but has not escaped strong criticism from some commentators.<sup>174</sup> In 1987 Garth, Nagel and Plager’s analysis of all federal class actions in the Northern District of California certified between 1979 and 1984 found that there had been a ‘dramatic shift’ from the initial model of the Lone Ranger or bounty hunter engaged in private law enforcement to a preoccupation with economic logic over incentives to sue.<sup>175</sup> The private attorney general model does not support advocacy before administrative agencies, only courts.<sup>176</sup> Garth, Nagel and Plager found that a significant number of class action private attorneys tended to ‘piggyback’ their cases on governmental investigations, even to the extent of copying the government’s complaint. For example, antitrust and securities cases depended largely on the investigative activities of governmental agencies. They commented:

‘A lawyer dependent on fees from a successful lawsuit naturally looks for the easy victories; creativity and innovation in the generation of the lawsuit are unlikely. Indeed, it looks as if the mercenary lawyers limit themselves largely to ‘no research’ lawsuits because of the efficiency of such a strategy. ... The mercenary lawyer takes fewer risks in defining the scope of the class. Accordingly, the attorney’s goal is to reduce the reach of the suit and the breadth of the defendants’ exposure so as to both maximise class certification and the probability of an expeditious and favourable settlement.’<sup>177</sup>

In the result, Garth *et al.* concluded that the ‘legal mercenary’ model of private attorneys ‘cannot fully realize the ideals implicit in the model of a private, institutional antidote to, or substitute for, governmental machinery’. By contrast, they found that the ‘social advocate’ model, involving publicly paid lawyers, delivered the best enforcement of public law goals. A federally funded legal services programme was established in 1965 as part of the ‘War on Poverty’, and ran in parallel with a notable stream of civil liberties and environmental cases.<sup>178</sup> Garth *et al.* found that 50% of the certified class

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<sup>173</sup> CR Sunstein, R Hastie, JW Payne, DA Schkade and WK Viscusi, *Punitive Damages. How Juries Decide* (Chicago, University of Chicago Press, 2002).

<sup>174</sup> See JC Coffee, Jr, ‘Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is not Working’ (1983) 42 *Maryland Law Review* 215; JC Coffee, Jr, ‘Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions’ (1986) 86 *Columbia Law Review* 669; B Garth, IH Nagel and SJ Plager, ‘The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation’ (1987-88) 61 *Southern California Law Review* 353; LM Grosberg, ‘Class Actions and Client-Centered Decisionmaking’ (1989) 40 *Syracuse LR* 709 (arguing that it is a delusion to suggest that the ‘client’ is the decision-maker in class actions, and that class action lawyers act like public officials).

<sup>175</sup> B Garth, IH Nagel and SJ Plager, ‘The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation’ (1987-1988) 61 *Southern California Law Review* 353.

<sup>176</sup> *Webb v Board of Education of Dyer County*, 471 US 234 (1985).

<sup>177</sup> B Garth, IH Nagel and SJ Plager, ‘The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation’ (1987-1988) 61 *Southern California Law Review* 353, 377.

<sup>178</sup> Such as *Associated Industries v Ickes*, 134 F.2d 694, 704 (2d Cir. 1943); *NAACP v Button*, 371 US 415 (1963); *Newman v Piggie Park*, 390 US 400, 402 (1968); *Alyeska Pipeline Service Co. v Wilderness Society*, 421 US 240 (1975)

actions in their 1979-1984 cohort was the product of law firms created directly by broad funding agencies<sup>179</sup> trying to generate legal power for the unrepresented and underrepresented in society. But there the private foundations had retreated and federal funding had shrunk for the Legal Services Corporation, whose cases had fallen from 3,584 in 1976 to 736 in 1986.<sup>180</sup> Garth concluded that the 'private attorney general' model works well when there is either subsidized social advocacy or a genuine governmental commitment to promote strong efforts by mercenary law enforcers. They suggested that efforts to reform the model and to create an antidote or substitute for governmental machinery—an effective enforcement institution independent of the vagaries of government—would fail unless they confront this basic proposition.

Garth *et al.* did identify some examples of private enforcement independent of government, but they concluded that there were very few such cases and the limiting conditions were 'severe indeed'.<sup>181</sup> The most important characteristic of such cases was that there were one or more aggrieved plaintiffs who sought legal representation and who were armed at the outset with the facts necessary to prove a violation of the law affecting a large but easily identifiable group of persons. These facts were simple and largely undisputed in the crucial respects; the lawyers could proceed much as they would in a relatively simple private lawsuit, without investing in significant research.

### Shifts: MDL and arbitration

Two important shifts have occurred in US practice in recent years in addition to the points noted above, such as the Congressionally mandated shift from state to federal courts for class actions. The points noted here are the increase in the use of the MDL procedure and the shift in consumer and employment mass from litigation to arbitration.

Various studies have demonstrated that class actions that have survived a class certification hearing are then transferred for centralised case management under the MDL procedure, even if thought they may share only one common issue.<sup>182</sup> The transfer is decided by the Multidistrict Litigation Panel of federal judges.

It has been noted above that courts expressed concern that class certification led inexorably to settlement on commercial grounds and irrespective of merits, and the total financial impact of the litigation could be so large as to run the risk of 'betting the company' and its survival on the decision of a single jury. In 1995, the Seventh Circuit decertified a class of haemophiliacs who had received blood contaminated with HIV, because the risk of bankruptcy put defendants 'under intense pressure to settle'.<sup>183</sup> In 1996, the Fifth Circuit overturned a decision certifying a nationwide class action by cigarette smokers, on the basis that the 'risk of facing an all or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low.'<sup>184</sup> In 1996, the Sixth Circuit overturned the certification of a class of individuals who claimed injuries as a result of penile implants manufactured by the defendants.<sup>185</sup> In 1997 and 1999, the US Supreme Court reversed massive class settlements

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<sup>179</sup> Notably ACLU, NAACP, the Sierra Club.

<sup>180</sup> *In Camera*, 10 Class Action Rep 93 (1987).

<sup>181</sup> The cohort contained 6 out of 46 such cases, dealing with length of pretrial detention, a pension plan, a company acquisition, insurance provisions restricting access on basis of race, and medication for mental patients.

<sup>182</sup> MH Redish and JM Karaba, 'One Size Doesn't Fit All: Multidistrict Litigation, Due Process, and the Dangers of Procedural Collectivism' (2015) 95 *Boston University Law Review* 95 (commenting that MDL amounts to a strange cross between The Wild West and political smoke-filled rooms of the twentieth century, which is hardly a combination that augurs well for either due process or the rule of law).

<sup>183</sup> *In re Rhone-Poulenc Rorer Inc.* 51 F. 3d 1293 (7<sup>th</sup> Cir. 1995).

<sup>184</sup> *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 746 (5<sup>th</sup> Cir. 1996) (citing *Rhone-Poulenc*, 51 F.3d at 1298).

<sup>185</sup> *In re Am. Med. Sys., Inc.*, 75 F.3d 1069 (6<sup>th</sup> Cir. 1996).

involving asbestos-related injuries. In *Amchem Products, Inc. v. Windsor*<sup>186</sup> it held that a proposed class of present and future asbestos claimants could not be certified as an opt-out class under Federal Rule of Civil Procedure 23(b)(3), since the claims were too disparate and ‘sprawling’ to be joined in a single representative class action.<sup>187</sup> In 1999, in *Ortiz v. Fibreboard Corp.*,<sup>188</sup> the Supreme Court again rejected an asbestos class settlement, on the basis that the settlement failed to satisfy the Rule 23(b)(1)(B) requirements for certification of asbestos claims against a single corporate defendant that the defendant had limited funds to pay the aggregated claims.<sup>189</sup>

In 1998, Federal Rule of Civil Procedure 23(f) enabled defendants to obtain appellate interlocutory review of federal district court decisions certifying class actions, which led to fewer cases being certified.<sup>190</sup> As noted above, PSLRA of 1995 and the 2005 CAFA had the effect of shifting most major class actions to federal court. The combined effect of these developments and the 1997 introduction of the MDL procedure resulted in a major increase in cases being transferred to the MDL procedure. Since then, many courts require that plaintiffs prove substantial portions of their cases on the merits at class certification, and several of the class certification requirements (class definition, numerosity, commonality, adequacy of representation, Rule 23(b)(2), and Rule 23(b)(3), became considerably more difficult to establish.<sup>191</sup>

Once cases were transferred under the MDL procedure, they were rarely returned to originating courts. In 2010, 2012 and 2013, the Judicial Panel on Multidistrict Litigation remanded respectively only 3.425%, 3.1%, and 2.9% of cases to their original districts.<sup>192</sup> A strong rationale for retaining cases was the hope of forcing a global settlement. For plaintiff attorneys, doctrinal uncertainties over weak claims could be avoided by packaging plaintiffs together in a global settlement. For defendants, as many cases as possible could be resolved in one stroke. Thus, the shift of products liability cases to the MDL resulted in non-class settlements.<sup>193</sup> Over time, however, the Panel has become more selective in the cases that it does and does not refer.<sup>194</sup>

The Supreme Court imposed a significant restriction in securities cases in 2014. At class certification for actions alleging violation of section 10(b) of the Securities Exchange Act, a presumption applies that plaintiffs relied on the misstatement. In *Halliburton v. Erica P. John Fund* (‘Halliburton II’), the Supreme Court held that ‘defendants must be afforded an opportunity before class certification to defeat the presumption through evidence that an alleged misrepresentation did not actually affect the market price of the stock.’<sup>195</sup> This was expected to reduce the number of certifications, albeit to add to the already high cost of certification hearings.<sup>196</sup>

The second main shift has occurred in cases based on contract claims, such as consumer trading and employment. Businesses have inserted arbitration clauses that oust court jurisdiction in relation to

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<sup>186</sup> 521 US 591, 622–25 (1997).

<sup>187</sup> *Id.* at 624–28.

<sup>188</sup> 527 US 815, 864–65 (1999).

<sup>189</sup> *Id.* at 851.

<sup>190</sup> RH Klonoff, ‘The Decline of Class Actions’ (2012) 90 *Washington University Law Review* 1.

<sup>191</sup> RH Klonoff, ‘The Decline of Class Actions’ (2012) 90 *Washington University Law Review* 1.

<sup>192</sup> EC Burch, ‘Remanding Multidistrict Litigation’ (2014) 73 *Louisiana Law Review* 399.

<sup>193</sup> TE Willging and EG LEE III, ‘From Class Actions to Multidistrict Consolidations: Aggregate Mass-Tort Litigation After *Ortiz*’ (2010) 58(4) *Kansas Law Review* 775.

<sup>194</sup> EG Lee, CR Borden, MS Williams, and KM Scott, ‘Multidistrict Centralization: An Empirical Examination’ (2015) 12(2) *Journal of Empirical Legal Studies* 211-235.

<sup>195</sup> *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2412 (2014).

<sup>196</sup> R Comolli and S Starykh, *Recent Trends in Securities Class Action Litigation: 2014 Full-Year Review Settlement amounts plummet in 2014, but post-Halliburton II filings rebound* (NERA, 2015).

disputes. In 2011, the Supreme Court upheld the validity of such arbitration clauses, notwithstanding the inability of consumers or employees to negotiate such standard terms in *Conception*<sup>197</sup> and affirmed the waiver of rights in 2013 in *American Express*.<sup>198</sup> As a result, a general move away from litigation towards arbitration is anticipated, and has accompanied a major growth in ADR and online dispute resolution (ODR) systems.

The combined effects of the shifts noted above are viewed as presaging major transformations in the US legal system.<sup>199</sup> Fitzpatrick considers that the logical conclusion of the Supreme Court's *Conception* and *American Express* decisions will be that businesses will eventually be able to eliminate virtually all class actions that are brought against them, including those brought by shareholders.<sup>200</sup> Accepting 'the evolving dysfunction of the American class action' Mullenix has called for the restriction of the class procedure to injunctive remedies and encouraging more public regulatory enforcement.<sup>201</sup>

## Conclusions

There is a significant level of class action activity in the United States, although the number of class actions is small compared to the general volume of litigation. Class actions differ in size and can include a lot of claimants. They cover a range of subject matter, the largest group being securities cases. There has been a shift away from social issues to cases that are driven by outcomes that are about money. Welfare cases are frequently initiated by public organisations so as to raise topical welfare and political issues. Individuals often initiate employment discrimination cases, in which a sense of grievance or public fairness is often a necessary motivator. The process can transform employment discrimination victims into activists, but they do not always personally benefit from the outcome in the way initially envisaged.

Money cases are mainly directed at large corporations with 'deep pockets'. Cases that parallel, or are based on, breach of public regulatory law, such as antitrust and consumer fraud statutes, tend to be brought subsequent to findings of infringement by public agencies (piggy-back). Securities cases are brought against large firms when share prices fall.

The class action mechanism enables enormous amounts of money to be claimed, even though individual consumer claims typically involve low sums. The success rates of class actions may be lower than expected, at least for some types of claims. Even though total notional settlement amounts may appear large, sums actually reaching individual claimants may be modest. These issues raise questions over the efficiency and effectiveness of the class action procedure that are unresolved.

The certification stage acts as a watershed for the outcome of a class action. A significant percentage of cases never reach certification stage, either because they are dropped or because a settlement is negotiated. Almost all class actions that are certified are settled and not tried. Settlements are usually negotiated on the basis of what the defendant will pay, and the agreed total sum is divided amongst the

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<sup>197</sup> *AT&T Mobility v. Conception*, 131 S. Ct. 1740 (2011).

<sup>198</sup> *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013).

<sup>199</sup> MH Redish, 'Rethinking the Theory of the Class Action: The Risks and Rewards of Capitalistic Socialism in the Litigation Process' (2014) 65 *Emory Law Journal* 451 (the class action relationship between client and attorney should no longer be viewed as principal-agent but as guardian-ward, and the system is plagued by externalities and perverse economic incentives); GM Vairo, 'Is the Class Action Really Dead? Is that Good or Bad for Class Members?' (2014) 64 *Emory Law Journal* 477 (utility as a prosecution tool has been compromised but certification for settlement purposes remains).

<sup>200</sup> BT Fitzpatrick, 'The End of Class Actions?' (2015) 75(1) *Arizona Law Review* 161.

<sup>201</sup> LS Mullenix, 'Ending Class Actions as We Know Them: Rethinking the American Class Action' (2014) 64 *Emory Law Journal* 399.

class. As a consequence, settlements can be based on incomplete evidence and incomplete understanding of the merits of a case. There are suggestions that this system of negotiated settlements, intermediaries' conflicts of interest, high transaction costs (especially discovery and large fees) produces some cases in which merits are poor ('blackmail settlements') and some cases in which a court might have awarded a higher total sum. Courts almost invariably approve proposed settlements. Significant issues remain over whether settlements are fair to possible future class members.

Under the US model, financial incentives are necessary to motivate private intermediaries to undertake law enforcement activities. Unquestionably, the US situation involves large economic forces. The justification for this model should rest on evidence that the size of the incentives is reasonable and not excessive, that the level of enforcement activity is justified on the basis of meritorious cases and settlements, that the costs imposed on defendants are justified and proportionate, that the system produces an adequate number of fair outcomes, and that illegal behaviour is adequately deterred, or that an adequate level of ongoing compliance with law is created. Reliable data on several of these requirements is scarce and difficult to verify, other than in relation to levels of transactional costs, damages and attorney compensation. The US model is clearly one that involves large sums of money changing hands. But do the outcomes justify the costs? The most important issue is whether claims that are brought, and particularly settled, have sufficient merit, and on that there is little reliable evidence but much assertion. A further issue concerns what anti-abuse mechanisms should be deployed, and how effective they are. Again, there is very little reliable understanding of how (and how well) different controls work.

The outcomes of class actions are difficult to assess. A great deal turns on the extent to which the system is effective in regulating corporate behaviour through deterrence based on large financial penalties. On that issue, there is little reliable empirical evidence, other than some that finds adverse financial impacts on firms and sometimes of employees.

As might be expected for a system in which there are high economic incentives to settle, since PSLRA 59% of the cases resolve (whether through settlement or dismissal) within three years from first filing.<sup>202</sup> This contrasts with the slowing effect of various safeguards thought necessary in European collective action models.

There are the following lessons from this rich and valuable experience for other jurisdictions that are contemplating the design of effective methods of collective redress. The starting point is to define the goals, such as delivering redress, regulating behaviour, or raising social and political issues. Certain types of procedure may be more or less appropriate for achieving individual goals. The empirical evidence that a particular procedure is capable of achieving a particular goal should be clear. For example, is it clear that private enforcement deters? Reliable sources of funding are needed in order to bring mass litigation. If public funding is not available, then certain types of case will not be brought, and there may be an access to justice gap. If reliance is placed on private funding, significant financial incentives may be required, and this will raise issues of conflicts of interest and increase the potential for abuse. Safeguards may be needed to control the system.<sup>203</sup> However, it is difficult to calibrate safeguards, and they may struggle to control large financial interests. A catch 22 situation arises that powerful financial incentives may be needed to incentivise private enforcement, which inherently creates abuse, but if significant balancing safeguards are imposed then litigation will be significantly dampened.<sup>204</sup> The dominance of private enforcement and class actions in the US system has chilled development of alternative means of achieving acceptable behaviour (through various forms of

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<sup>202</sup> R Comolli and S Starykh, *Recent Trends in Securities Class Action Litigation: 2014 Full-Year Review Settlement amounts plummet in 2014, but post-Halliburton II filings rebound* (NERA, 2015).

<sup>203</sup> R. Money-Kyrle and C. Hodges, 'Safeguards in Collective Actions' (2012) 19(4) *Maastricht Journal of International and Comparative Law* 477-504.

<sup>204</sup> C Hodges, 'Collective Redress: A Breakthrough or a Damp Squibb?' (2014) 34 *Journal of Consumer Policy* 67-89.

regulatory mechanisms) and delivering redress (through alternative dispute resolution, ombudsmen, compensation schemes or other means). Such alternative mechanisms are emerging strongly in Europe.<sup>205</sup> It is necessary to decide which mechanisms are most effective, efficient and desirable, and this evaluation should be based on empirical evidence. The history of collective actions in Europe indicates a low level of demand by judges for collective rules.<sup>206</sup> A way forward may be to prioritise pathways so that cases are funnelled through effective mechanisms in preference to others, in which case the collective action may end up as a last resort.

The safeguards in the EU model induce delay (often major) that is not seen in the US model, since the size of the economic incentives in the latter induce settlement

Third, the empirical evidence shows that collective actions in most EU jurisdictions are rarely used. They can also take a long time. Whilst some might wish to believe that current European collective action models are not right, and that some other model would work, it is argued that the evidence shows that *no* EU model would work well.

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<sup>205</sup> C Hodges and A Stadler (eds), *Resolving Mass Disputes: ADR and Settlement of Mass Claims* (Edward Elgar, 2013); C Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) *European Review of Private Law* (forthcoming).

<sup>206</sup> C Hodges, 'Collective Redress: A Breakthrough or a Damp Squibb?' (2014) 34 *Journal of Consumer Policy* 67–89.



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