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THE INSTITUTIONAL DIMENSION OF CONSUMER PROTECTION

Samuel ISSACHAROFF* and Ian SAMUEL**

INTRODUCTION

One of the central functions of the state is protecting the integrity of contracts such that markets and private ordering may thrive. This is such a well understood theme in liberal political theory as to appear to need no further exposition. Unfortunately, the classic account envisioned a single seller and a single buyer who needed the state only to make sure that cross-temporal commitments between purchase and delivery would be honoured and that disputes could be resolved without recourse to private retaliation.

As important as this account may be, it is necessarily incomplete. As the scale and scope of markets change, so too must the role of the state in providing assurances against multiple forms of market malfunction. In some markets, particularly those that are close-knit with a great deal of repeat play among the participants, reputation and other informal mechanisms may be sufficient to police against most improper conduct. There, the role of governmental supervision might well be limited to that of the final guarantor that commitments to pay and deliver are honoured. But in our increasingly global economy, with buyers and sellers interchangeable and unknown to each other, community mechanisms of enforcement are difficult and there is a corresponding push for greater governmental supervision.

We start from a simple proposition that the integrity of markets requires more than simply enforcing reciprocal terms of exchange. As the breadth of commercial activity expands and as exchange takes on forms unadorned by actual human contact, protecting consumers against harm becomes an essential prerequisite to the healthy functioning of markets. Fraud, product failure, and personal injury threaten the free exchange of goods and services by constricting the networks of

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trust and exchange and sapping the vitality of markets.¹ Consumer protection is an integral part of the role of the state in mature market societies; our basic approach is to define the risk to markets as a social harm that can be managed in many ways, by many institutions.

Simply acknowledging the need to police markets and protect consumers is an important but limited first step. All reasonably developed societies do that in some fashion. What is of interest for us is how that is done and what forms of institutional arrangements follow from the array of choices that remain. In this chapter, we take up two topics: first, the typology of harm management itself. By dividing enforcement agents into “public” and “private,” and the moments of enforcement into *ex ante* and *ex post*, it is possible to develop a typology. For example, the prior governmental approval of products before they may enter the market is a classic form of public *ex ante* regulation. A tort suit by an injured consumer is a corresponding private *ex post* form. Recently, American law has been dominated by disputes over how national *ex ante* regulation interacts with state-by-state *ex post* liability: if the Food and Drug Administration approves a medical device, for example, may an individual state’s tort law hold the manufacturer liable for defective designs?

Our main focus, however, is not so much on identifying the forms that regulation might take, but on the institutional demands made by these different modes of regulation. It is here that the temporal dimension emerges as critical. The management of social harm can be either *ex ante* or *ex post* or, as with the public/private distinction, a mixture of both. Regulation can act prescriptively to limit the potential for injurious conduct or it can react retrospectively to provide compensation to those harmed and attempt to get private actors to condition their behaviour in anticipation of liability rules. Each of the regulatory options must have its own supporting institutions and its own societal infrastructure to make it work. The choice of how to regulate harm ought to be as sensitive to what the tool requires as it is to the shape of the harm itself. These choices are about institutional design and competence as much as alleviation of substantive harm.

Our aim here is not to revisit the debates about *ex ante* versus *ex post* regulation. These are complicated issues and there are many factors that have to be weighed in the balance, as there are trade-offs between centralized public enforcement as opposed to decentralized private enforcement. In this chapter, however, we are concerned not simply with whether markets can be made more vibrant by lifting *ex ante* forms of regulation² – a view that underlies most efforts at deregulation

1 See generally Karen S. Cook et al., *The Emergence of Trust Networks under Uncertainty: The Case of Transitional Economies*, in *CREATING SOCIAL TRUST IN POST-SOCIALIST TRANSITION* (Janos Kornai ed. 2004).

2 There are, to be sure, complaints about every form of regulation, including those sectors of the American economy in which *ex ante* regulation has primacy. See, e.g. Michael R. Ward, *Drug Approval Overregulation*, *REGULATION: THE REVIEW OF BUSINESS & GOVERNMENT* (1992).

– but also whether the right processes for *ex post* accountability are in place. The American experience with *ex post* regulation turns critically on the role of private enforcement to supplement more limited state responsibility for compensation and deterrence. The ability to harness private enforcement depends not only on the substantive laws governing compensation, but also on the incentives to ferret out wrongdoing, provide efficient resolution of similarly situated claims and compel the proper level of internalization of norms of proper market conduct. Our claim is not that a particular form of regulation is superior across all settings. Rather, it is that each regulatory strategy must ensure that the proper institutional actors are in place for its effective implementation.

To give but one example, the US relies heavily on the incentives for private actors to unearth wrongdoing after the fact and to force future actors to discount the cost of enforcement into their primary decisions on risk and precaution. But the American approach not only allows individuals to seek compensation, but actually creates incentives for private actors to enforce substantive laws and be compensated when their efforts bear fruit – termed the private attorney general model. These private attorney generals are empowered to act on behalf of either individuals or a broad group of similarly situated individuals, bound together by the proceedings and a supervising tribunal, with incentives for the undertaking created from the proceeds of the enforcement action. Consider the civil rights statutes,³ which permit the recovery of “a reasonable attorney’s fee” upon successful litigation.⁴ This represents an institutional commitment (albeit one that comes at little direct cost to the public generally) to private enforcement of individual rights. Without this commitment, the underlying prohibition against “deprivation of any rights, privileges, or immunities secured by the Constitution and laws”⁵ would have little force.

If a decision is made to move to private, *ex post* enforcement of consumer protection law, then there must be corresponding institutional commitments, whether in the form of government institutions, NGOs, private aggregation mechanisms or the class action. These commitments are not without costs, of course. Private enforcement invariably turns on the incentives for private gain and there is invariably a loss of the public spiritedness represented (at least in principle) by disinterested governmental supervision. Nonetheless, the core argument is that all regulatory regimes have costs, and that if in certain circumstances a private-enforcement, after-the-fact liability regime is deemed best suited to the problems of democratised markets, then there must be corresponding provisions for the emergence of the private actors who will pursue that enforcement.

3 42 U.S.C. §1988.

4 *Id.*

5 42 U.S.C. §1983.

In Part I, we provide a spatial model of the typology of regulation. By mapping regulation on a pair of axes, one representing the moment of enforcement and the other representing the public/private divide, it is possible to classify the various schemes of enforcement fairly comprehensively. In Part II, we dig deeper and examine the institutional dimension of this enforcement: what, beyond the shape of the substantive harms at issue, ought to shape the choice of regulatory tools?

1. THE TYPOLOGY

Social harm can be managed in many ways. The term “regulation” often conjures up images of command-and-control, top-down edicts by some public agency; such edicts certainly count, but they do not exhaust the field. Regulation of social harm can also be achieved by harnessing private actors, in primary place of or in cooperation with the government. A tort system fits this model: the government provides the courts, but private actors are largely responsible for seeking redress of their own injuries.

There is another dimension as well. The management of social harm can be either *ex ante* or *ex post* or, as with the public/private distinction, a mixture of both. Broadly, this means that regulation can either try to anticipate the likely sources of harm and either prohibit certain forms of conduct or prescribe the precautionary steps necessary for avoidance of harm. Such regulatory interventions are most likely efficient where there is sufficient predictability of the sources of harm and the information necessary to ameliorate the conditions is likely ascertainable efficiently by government authorities. Thus, for example, regulators may prohibit forklifts capable of raising loads more than five metres off the ground or may require a protective cage over the head of a forklift operator. In contrast, regulators may decide that specific safety precautions are too site-specific or that optimal precautions are too variable to be suitable for direct regulatory commands. In such circumstances, tort liability – even strict liability – may better create the incentives for parties with superior access to information about risk and the cost of prevention to design a precautionary protocol.

Laying these axes out on a graph might look something like this:

The Institutional Dimension of Consumer Protection

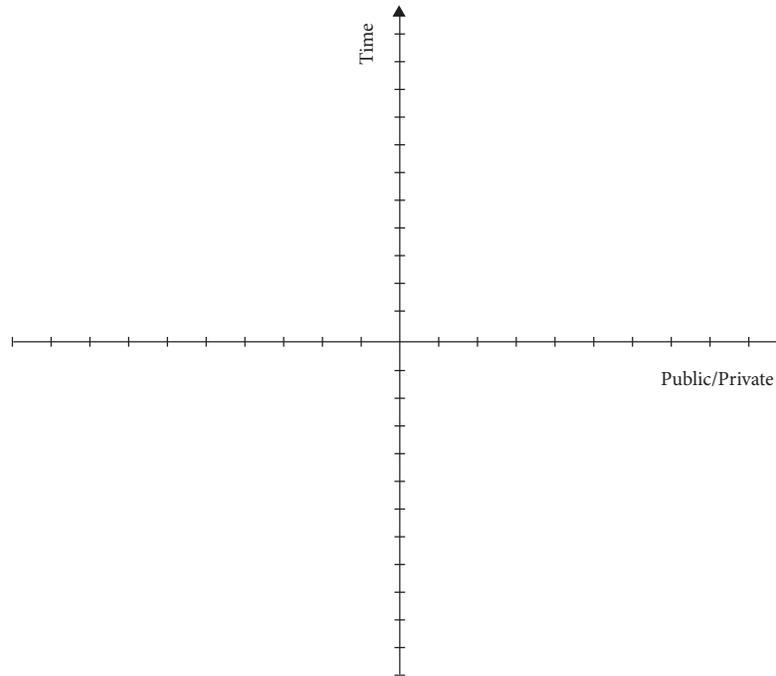


Table 1.

The axes of the graph, somewhat simplistically, represent two essential choices that must be made when harm is to be regulated: when and by whom. Lending itself most naturally to a spectrum is “when” is the moment of enforcement (by which we mean the moment at which coercive state power is exercised). Regulation that occurs entirely before harm ever takes place is at one end of the spectrum and regulation that begins only after the harm has been completely realized is at the other. The other axis is the public/private distinction. The further one travels along this axis, the more government is involved as a primary regulator. At some level, of course, the government must provide the instrumentalities of legal enforcement, such as court systems, positive law and the coercive ability to enforce judgments, but beyond this minimum, the limits of government regulation are (as experience demonstrates) bound only by the imagination.

These regulatory choices interact, however and as we map several familiar forms of regulation onto these axes, we find familiar patterns. In the upper left quadrant of the graph, we find public, *ex post* enforcement: harm occurs and the government responds to it. An example is the ordinary criminal law. If a citizen is robbed, the government dispatches detectives to find facts, a public prosecutor draws up an indictment and, in fact, even if the primary victim does not wish for

the case to proceed, the prosecuting authority may usually prosecute the criminal anyway, emphasising the truly public nature of the enforcement.

As regulation moves into the upper right quadrant, we find private *ex post* regulation of harm. In the American system, this is where we would situate the private law suit or its collective form, the class action.⁶ In such cases, the harm has already occurred, so this mode of regulation is essentially reactive; however, the government provides the courts and the public law on which the private litigants will rely in the settlement of their dispute. In such cases, however, there must be one more form of public support if such cases are to fill a role in justifying suits where individuals may not have the level of harm that would justify seeking redress in the costly world of litigation. In such cases, it is incumbent upon the state to provide a mechanism for overcoming the collective action problem that allows diffuse harms to be visited upon a broad number of individuals, a subject to which we shall return.

In the bottom left, regulation is typified by *ex ante* government action. Regulation of speech achieved by “prior restraint” is of this sort. A more palatable example is the FDA’s “Premarket Notification” program.⁷ Under §510 of the Federal Food, Drug and Cosmetic Act, for example, many device and pharmaceutical manufacturers are required “to notify FDA, at least 90 days in advance, of their intent to market a medical device.”⁸ This allows prospective investigation and approval by the agency.⁹ Regulated devices cannot be brought to market absent of compliance with regulatory requirements, and it is the government (not private parties who fear prospective harm) that enjoins the product’s sale absent of such compliance.

Finally, the bottom right quadrant represents an unusual method of regulation: *ex ante* private regulation. Though a bit odd to conceive of, we believe this is the domain into which contract law best fits. In contract, private parties make advance agreements that require each to take whatever steps the other feels best to avoid harm. The simplest example can be found in liquidated damages provisions negotiated by sophisticated parties. But even in more diffuse cases, there are arguments that private parties should be incentivised to contract a set of prearranged contingencies for malfeasance or the failure of a joint venture. Thus, for example, in US bankruptcy law, there is currently a “growing schism”¹⁰ driven by scholars who want to eliminate much public bankruptcy legislation. Their

6 See generally AMERICAN LAW INSTITUTE, PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION (2007).

7 21 U.S.C. §360 (2000).

8 U.S. Food and Drug Administration, §510(k) Overview, www.fda.gov/cdrh/510k.html (last visited 15 February 2008).

9 21 U.S.C. §360(k) (2000).

10 Susan Block-Lieb, *The Politics of Privatizing Business Bankruptcy Law*, 74 AM. BANKR. L.J. 77, 77 (2000).

belief is that bankruptcy is best regulated not by the government, but privately. “The notion that contract can better provide any incentive forms the theoretical divide... between critics of and defenders of bankruptcy law.”¹¹ Contract, on this view, may be a better regulatory tool for bankruptcy; private, *ex ante* regulation can substitute, in other words, for public, *ex post* division of spoils.

Collecting these archetypes, one might alternatively visualise them this way:

	<i>Public</i>	<i>Private</i>
<i>Ex Post</i>	Criminal Law	Tort
<i>Ex Ante</i>	Command-and-Control	Contract

Table 2.

It should be admitted that this typology is not absolute. Contract law requires a court system to back it up should one party be in breach. The FDA’s pharmaceutical regulations are routinely the source of substantive tort law, as with presumptions of negligence created by failure to conform to regulatory requirements¹² and with a reliance on the tort law to provide compensation even where federal regulatory law has pre-emptively established the terms of liability. The criminal law is meant to deter as well as punish. The threat of an *ex post* class action may induce parties to change their behaviour before the harm occurs. In this way, even “pure” examples of each regulation bleed into one another.

Moreover, some modes of regulation are explicitly designed to be hybrids.¹³ For example, the government often requires a bond (public, *ex ante* regulation) before construction of a large building is undertaken; this bond could then be used to pay the judgment if a private party sues in tort after injury (private, *ex post* regulation).¹⁴ Or consider the domain of antitrust. The Justice Department

11 Barry E. Adler, *Finance’s Theoretical Divide and the Proper Role of Insolvency Rules*, 67 So. CAL. L. REV. 1107, 1111 (1994).

12 *E.g.*, *Merrell Dow Pharm. v. Thompson*, 478 U.S. 804 (1986). In many instances, the federal regulatory issue is directly tied to after-the-fact claims in the tort system. *See, e.g.* “The violation of federal statutes and regulations is commonly given negligence per se effect in state tort proceedings.” Restatement (Third) of Torts §14, Reporters’ Note, p.195 Tent. Draft No.1, Mar. 28, 2001 Comment *a*. *See also* W. Keeton, D. Dobbs, R. Keeton, & D. Owen, *Prosser and Keeton on Law of Torts*, §36, p. 221, n. 9 (5th ed. 1984) (“[T]he breach of a federal statute may support a negligence per se claim as a matter of state law” (collecting authority)).

13 *See* Samuel Issacharoff, *Regulating After the Fact*, 56 DEPAUL L. REV. 375 (2007).

14 For example, vendors who contract with the California government to provide health equipment are subject to a bonding requirement that ensures accountability should the equipment prove faulty. Cal. Welf. & Inst. Code §14100.75 (West 2001).

routinely prosecutes antitrust violations and secures injunctions against further anticompetitive practices. This is public, *ex post* enforcement. Equally routine, however, is the typical follow-on suit for treble damages by the competitors injured by the anticompetitive practices now enjoined; private, *ex post* enforcement. The combinations are basically endless.

Moreover, not every combination works equally well. In American law, there is an uneasy relation between the efforts to coordinate liability standards through federal regulation, yet provide for compensation through state tort law remedies.¹⁵ The resulting battles over regulatory pre-emption of state law remedies force an uncomfortable confrontation with the adequacy of the pre-market supervision under the federal regulatory scheme. Most recently, in *Riegel v. Medtronic*,¹⁶ the Supreme Court of the United States held that certain common law claims against medical device manufacturers (classic *ex post* tort suits) were barred by the FDA's pre-approval process. Because of the national nature of the FDA's regulations and the legislative prohibition on state-level requirements that "differ" from those regulations, the Supreme Court held that certain state remedies were barred. For the Court, the regulatory system for medical devices "is in no sense an exemption from federal safety review-it *is* federal safety review."¹⁷ The federal regulation represented a studied cost-benefit determination of the optimal standards for particular medical devices and, accordingly, could not be second-guessed or overridden by after-the-fact jury re-evaluations of risk management for a particular device. Even here, however, injuries caused by violations of federal standards are still to be compensated through *post-facto* common law litigation: "State requirements are pre-empted under the MDA [Medical Devices Act] only to the extent that they are 'different from, or in addition to' the requirements imposed by federal law... Thus, [the MDA] does not prevent a State from providing a damages remedy for claims premised on a violation of FDA regulations; the state duties in such a case 'parallel,' rather than add to, federal requirements."¹⁸ Though this topic is too enormous for this chapter, the interplay between different forms of regulation at different levels of government complicates the picture even further, and as *Medtronic* illustrates, those complications rage.

Further, there are difficult questions of risk trade-offs that may dictate caution in opting for an *ex post* liability regime. In many areas, such as the siting of a nuclear power plant or the development of a vaccine with known secondary effects in subsets of the population, there may be a need for society to assume the known risk of harm because of the significant benefits to be realised. *Ex post* evaluation

15 For an extensive discussion of this point, see Samuel Issacharoff and Catherine M. Sharkey, *Backdoor Federalization*, 53 U.C.L.A. L. REV. 1353 (2006).

16 128 S. Ct. 999 (2008).

17 *Id.* at 1007.

18 *Id.* at 1011.

of risk, in the case of a leak of radioactive steam or a child injured by a vaccine, may lead to over deterrence in trial settings overcome with the sense of inevitability of the realised adverse event.

A final difficulty is posed by the remedial injunction. Consider a suit brought in response to harm, seeking monetary damages but also an injunction against future conduct of the same kind or an injunction to engage in specified prospective affirmative actions. This sort of “damages plus injunction” remedy is becoming increasingly common (though more so in Europe than in North America); some have gone so far as to say that it upsets the *ex post* vs. *ex ante* distinction altogether.¹⁹ Moreover, injunctions may be issued judicially or – increasingly – by administrative agencies.²⁰ When relief is both backward-looking and prospective, and includes private compensation as well as publicly administered rules of conduct, the simple view above begins to show fissures. The indirect role of litigated judgments in conditioning future behaviour becomes a direct form of regulation, one that is negotiated between private parties and is designed to have express external consequences. When the boundary line is breached, the world of private dispute resolution takes on the air of delegation of public regulation to private parties. A variation on this occurs when litigation spurs legislative attempts to regulate *ex ante* what the lawsuit challenged *ex post* – sometimes with accompanying relief from liability.²¹ Legislative retroactive judgments – in much the same fashion as judicial prospective decrees – collapse many of the critical divides between the public and the private, as well as the temporal divisions between *ex ante* regulation and *ex post* accountability.

This is all true. However, this typology can be a useful starting point when thinking about regulation and, specifically, the use of the private class action as a form of private, *ex post* enforcement – especially in cases, such as consumer fraud, in which the scope of the underlying harm might not justify *ex post* private enforcement by aggrieved consumers acting alone. Critics of class actions, in other words, might use this typology to highlight alternatives, such as the extent to which command-and-control regulation (public, *ex ante* regulation, in other words) might or might not be a useful substitute. The typology is a menu for reacting to social harm. While the right menu option will depend on the harm being regulated, it is clear that in some fashion, at some point, the choices the grid

19 See, e.g. Fabrizio Caffagi & Hans Micklitz, *Collective Enforcement of Consumer Law: A Framework for Comparative Assessment*, 16 *European Rev. of Private L.* 391 (2008).

20 *Id.*

21 An example is provided by the dispute in the United States over the Foreign Intelligence Surveillance Act. Major telecommunications firms were accused of widespread violations of American wiretapping law and a damages action was brought in federal court for redress – a classic consumer protection suit, though one with national security overtones. The Congressional response was a legislative prohibition against conduct of the same kind, coupled with a release from civil liability for the firms being sued. Eric Lichtblau & David Stout, *House Passes Bill on Federal Wiretapping Powers*, *New York Times*, 21 June, 2008.

presents must be answered: who will do the enforcing? And will the aim be to avert harms or to deter future wrongs by compensating those injured when they occur? Even in the hybrid cases (such as a damages-injunction remedy), the same filaments are present: the damages represent an *ex post* private response, while the injunction will be more like *ex ante* regulation. In the advanced cases, the fit will be imperfect, but the guidelines are basically correct. And, at any rate, advanced permutations of the typology require first an understanding of the basics.

An important question lurks behind the decision of what to order from the menu. To strain the metaphor, some regulatory dishes only work if the kitchen is well equipped. The institutions present or absent in society are crucial when deciding how to regulate harm. We take this institutional dimension up in the next part.

2. INSTITUTIONS AND PRIVATE ENFORCEMENT

Let us assume, for the purposes of this chapter, that there are significant societal interests in providing means of avoiding social harms and assume further that the costs associated with a controlling regulatory regime render it a suboptimal form for either redress or prevention. In many consumer contexts, for example, the fluidity of demand requires that products be introduced and withdrawn quickly in response to market conditions. Requiring new products to undergo a necessarily dilatory process of regulatory prescreening threatens the vitality of markets and depresses the ability to meet consumer demand. In such circumstances, both producers and consumers may be better served by a system which permits liberal entry into the market and provides sufficient mechanisms of accountability such as to diminish the risk of fraud, harmful products and other forms of opportunistic misconduct.

At the same time, one cannot simply will such a system of legal accountability into being, any more than one can simply pass laws instructing all parties not to misbehave. Each of the regulatory options must have its own supporting institutions, its own societal infrastructure, to make it work. The choice of how to regulate harm ought to be as sensitive to what the tool requires as it is to the shape of the harm itself; these choices are about institutional design and competence as much as alleviation of substantive harm. When social harm is going unmanaged, the answer may be quite often that the social institutions that are needed to deploy regulatory tools do not exist yet.

Our focus here is on the institutional prerequisites for enforcement mechanisms that are both private and *ex post*. Many advanced societies disfavour both *ex post* and private methods of enforcement of laws intended to redress consumer harm.

So be it. There are reasons to believe that these are both necessary and efficient. But we do not press that point here. Instead, we ask what forms of legal organisation are necessary if there is to be after-the-fact enforcement in the consumer context, a context heavily defined by a deep asymmetry between the minimal loss to the purchaser and the possibility for illicit gain realised at the expense of small harms to a broad purchasing public. Unlike the personal injury scenario represented by *Medtronic*, in the classic consumer case, the limited individual harm renders most claims for legal redress unviable, what is commonly termed a negative value suit in which the costs of prosecution likely exceed the anticipated potential recovery.

Accordingly, it is incumbent for legal systems seeking to liberalise market entry and innovation to ask what institutions are required for private, *ex post* enforcement, primarily those that may be the least obvious. There is a broad body of critical commentary concerning FDA-like institutions with the power to regulate pharmaceuticals. Such regulatory bodies will be criticised for the relative delays in bringing products to market, a cost that may be justified by the unique capacity for harm represented by certain categories of medical devices or pharmaceuticals. In globalised markets, however, extensive pre-market approval processes are increasingly assumed to be intolerable restraints on necessary innovation. Wherever the line is ultimately drawn on the scope of pre-market regulatory supervision, it is clear that for an agency such as the FDA to perform its function properly, there must be certain staffing levels, administrative expertise and procedural forms that can ensure appropriate supervision.

But assuming market liberalisations such that, at least in the US, “the creation of [product standards] is still largely a private procedure”,²² there must be a corresponding discussion of what institutions are required for effective regulation, no less than in its public counterpart. There are of course many candidates, just as there are in the public domain. The American class action, the English Group Litigation Order, the newly minted Italian use of prosecuting associations with individual rights of intervention (now termed a “class action”)²³ – all represent efforts at providing an organizational vehicle for the collective enforcement of private claims for redress.

One might think that private enforcement requires the fewest social institutions. After all, in the Hayekian state of nature, all that is needed are litigants, the common law and a court of competent jurisdiction; not even

22 Geraint G. Howells, *The Relationship Between Product Liability and Product Safety-- Understanding a Necessary Element in European Product Liability Through a Comparison with the U.S. Position*, 39 WASHBURN L.J. 305 (2000).

23 Legislative Decree 6 September 2005 no. 206 (in Ordinary Supplement no. 162 to the Official Journal 8 October, no. 235). – Consumer Code, pursuant to Article 7 of Law no. 229 of 29 July 2003 (collective compensation action). The most recent version went into effect on 1 July 2008.

legislatures are required to address social harm in this fashion and may even represent an unwelcome intrusion.²⁴ When disputes are no more complicated than one schoolboy kicking another,²⁵ this may be so. But as societies and their markets become more sophisticated, this utopian picture rapidly develops fissures and social institutions must grow up to respond to the challenge.

The central problem is one of incentives for opportunism as opposed to incentives for enforcement. As the scale of consumer transactions grows, there are great potential gains to be had from what may be termed “democratised theft.”²⁶ Whenever a single actor is engaging a multitude, small-scale gains from misrepresentation, charges, quantity delivered, etc. may translate into a very substantial gain at relatively low cost to each affected consumer. So, for example, major airlines may agree not to compete on price for routes to one another’s “hub” airports, raising the cost of many tickets by only a small amount but representing a major aggregated gain to the industry.²⁷ These schemes threaten to compromise the integrity of markets and, if unchecked, may be a drain on the ability to transact efficiently.

Such exploitation presents a dual-headed problem. For one, ordinary market incentives to treat one’s customers well will probably fail in instances like these; there is every reason to believe that neither firm reputation nor market competition is sufficient to prevent this type of opportunism. These schemes are often carried out in secret and are difficult to detect, and even once detected, are conceptually difficult for many consumers to parse so that they may update the reputation of the firm. Moreover, even in those industries competing on price, the marginal cost to each consumer of such “democratised theft” is so small as to likely be overwhelmed by other factors such as materials cost or even taxes.

Equally problematic, the low level of harm to any particular consumer compromises private enforcement of consumer claims. The amount at stake for any one person does not justify the cost of seeking legal redress, even though the harm in the aggregate is potentially enormous. A legal claim that is worth less than the transaction costs of litigation is known as a “negative value suit” and such suits represent a major barrier to private enforcement, one with which institutions (if private, *ex post* enforcement is to be the tool) must grapple.

24 See FRIEDRICH A. HAYEK, *THE ROAD TO SERFDOM* (1944).

25 *E.g. Vosburg v. Putney*, 80 Wis. 523 (1891) (in which one schoolboy kicks another to unexpectedly disastrous results).

26 By this term we mean the increased ability of concentrated providers of goods and services to engage large numbers of consumers without direct person-to-person exchange and with little direct accountability to those individuals in terms of community reputation outside the diffuse market. The term is intended to invoke the humour found in AMBROSE BIERCE, *THE DEVIL’S DICTIONARY* (1906) (“CORPORATION, n. An ingenious device for obtaining individual profit without individual responsibility.”).

27 See *In re Domestic Air Transportation Antitrust Litigation*, 137 F.R.D. 677 (N.D. Ga. 1991) (in which essentially these facts were alleged).

Different societies deal with this in different ways. Many countries seek to minimize the cost of seeking legal redress, by subsidizing the cost of private enforcement through the shifting of fees and costs in litigation. For example, the so-called “English rule” or “loser pays” model requires the losing party to pay the legal fees of the winner.²⁸ If liability is fairly clear, this will help reduce the transaction costs of litigation, but it cannot eliminate them: even a “free” lawsuit will be more trouble than most will endure. Even a recovery whose transactions costs are subsidised by the English rule does little to motivate a consumer to initiate proceedings when the total recovery to the consumer may amount to a relative trifle. Moreover, if liability is not clear, the English rule may worsen the problem by turning private enforcement into a high-stakes gamble. It is clear that in the “amount at stake vs. cost of legal redress” mismatch, minimising the cost of legal redress cannot work – at least not alone.

The alternative is to boost, via aggregation of claims, the “amount at stake” in any given lawsuit. Unlike providing a direct subsidy to the individual with a claim for redress, the object here is to level the playing field by creating similar incentives to litigate on both sides of the dispute. In effect, this approach assigns a portion of each consumer’s claim to a litigating agent, who then has an incentive to invest in the assertion of the collective entity’s potential recovery. While many European countries are now looking to forms of collective redress, there is an accompanying “folk wisdom” that the American response must be avoided.²⁹

Our aim is not to take up all the arguments concerning the familiar mechanism of the class action, but rather to situate the class action within a system of private *ex post* mechanisms of providing for redress while overcoming the negative value of typical consumer claims. Once situated in a scheme or regulatory enforcement, however, it should not be surprising that class actions require supporting institutional arrangements, as do all enforcement devices. For one, a court system with the authority in positive law to aggregate private claims is required,³⁰ but merely the right statutory incantation is not enough. Most obviously, if any system of consumer harm is to turn so heavily on the courts, the judiciary must possess a sufficient degree of independence that rendering potentially enormous judgments against major industrial players is a realistic possibility. But far more than just “good judges” are required for this sort of enforcement to work.

28 For more on the English Rule and fee shifting generally, see John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person’s Access to Justice*, 42 AM. U. L. REV. 1567 (1993).

29 The issue of the European distrust of American entrepreneurial agents in litigation is taken up more fully in Samuel Issacharoff & Geoffrey P. Miller, *Will Aggregate Litigation Come to Europe?*-----, ___ Vanderbilt L. Rev. ___ (forthcoming 2008).

30 See, e.g. Fed. R. Civ. P. 23.

It has been argued by others that “the rule of law” has requirements far beyond the formal institutions of government.³¹ Our claim is that effective consumer enforcement relies on some of the same non-governmental institutions. This is currently the biggest issue in the European debates over private enforcement. To date, the European efforts have shown a marked distrust of lawyer entrepreneurialism as the driving force behind collective actions. Instead, they have opted for either group consolidation orders that coordinate among litigants already in the legal system or for representative actions brought by non-governmental organisations. Even these, as in the newly minted Italian statute, have no capacity to seek damages for private harms.

What separates the European efforts from the American practices is precisely the creation of the institutional foundation for the private bar to assume the risks and rewards of representing claimants who are unable to fend for themselves. The question, therefore, is not whether Europe should or should not have American-style class actions. On that score the answer is easy: there is no obvious imperative for European legal systems to have any particular institutional actor. Europe need not have American-based forms of representation in litigation any more than Europe need reproduce the American presidential system or the Senate or the Electoral College as forms of political representation.

If, however, *ex post* private enforcement is to be a part of the legal landscape, then the question shifts once again. The issue now becomes what are the institutional mechanisms that can overcome the negative value of the typical consumer claim such as to compel accountability. If that is the object, then the private bar, for its part, must develop as an institution capable of overcoming the collective action barriers to private enforcement. This in turn requires entrepreneurs specialising in seeking out certain types of consumer harm and ones accustomed to working independently of the state. The emergence of those entrepreneurs correspondingly depends on the quality of the bar itself, which in turn depends on the mechanisms and quality of organised legal education.³² Professions outside of the law must develop supporting institutions as well: complex, aggregated medical harms will require the existence of sophisticated medical experts to assist private attorneys generally in the development of claims.³³ Complex, aggregated accounting frauds will require sophisticated private accountants who can detect, document and testify to the existence of

31 Jeffrey Kahn, *The Search for the Rule of Law in Russia*, 37 GEO. J. INTL. L. 353 (2006).

32 This corresponds with Kahn’s view that “the rule of law also requires a variety of non-state institutions: organized legal education, a professional bar, and a myriad of supporting professions.” *Id.*

33 *E.g. Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1996) (in which millions of injuries from asbestos were alleged).

those frauds.³⁴ None of these institutions will spring into being automatically, and none of them will emerge merely by legislating into existence the formal structures of a class action. Such existence is a necessary but insufficient step for truly effective private consumer enforcement.

Thus, if social harm is going unmanaged despite the formal, first-order presence of the tort and other consumer-protection laws and courts that would otherwise enable its management, this chapter suggests the answer may lie in the absence of the necessary supporting institutions. Especially in developing or emerging nations attempting to build a system of regulation from the ground up, these institutions deserve special attention, and are not guaranteed to exist. On this level, the “one vs. the multitude” problem is recreated: those who would perpetrate a sophisticated accounting fraud on their consumers will purchase the services of skilled accountants. The public as a whole, however, has a more diffuse interest in ensuring the development of professional ethics, private monitoring organisations, sophisticated accountancy and so on. The best lawyers can be flown in from overseas to defend a class action when there is much at stake; for a nation to develop a skilled plaintiff’s bar takes time and investment.

The question in the end is whether there is the capacity to harness private enforcement that will have an incentive to challenge diffuse wrongdoing, provide efficient resolution of similarly situated claims, and compel the proper level of internalisation of norms of proper market conduct. One such institutional response is the private attorney general who is empowered to act on behalf of a broad group of similarly situated individuals, bound together by the proceedings and a supervising tribunal, with incentives for the undertaking created from the proceeds of the enforcement action. In other words, a private class action can be an important complement to well-functioning regulatory overseeing of consumer markets. But such private enforcement will not emerge without the necessary institutions – institutions that come with costs well beyond those found in any agency relationship. The most critical institutional arrangements for the existence of class actions are the most controversial. First, there must be an incentive for private gain for the bar to assume the role of venture capitalists in prosecuting claims for individuals who cannot be relied upon to underwrite the costs of enforcement. Second, there must be a low-cost mechanism, such as the American opt-out mechanism for class actions, which allows private interests to be aggregated without overwhelming transactional barriers.

It is precisely the entrepreneurial side of class actions and the non-contractual nature of the self-volunteered private attorney generals that creates the greatest notoriety both in the US and abroad. Nonetheless, all regulatory regimes have costs and the agency costs of private enforcement are no exception. But if there is

³⁴ *E.g.* In re Cendant Corp. Prides Litigation, 243 F.3d 722 (3d Cir. 2001) (in which the deliberate manufacture of false revenue over a multi-year period was alleged).

to be a private enforcement, after-the-fact liability regime well suited to the problems of democratised markets, there must be corresponding institutional arrangements that make such enforcement viable. The American class action is an evolutionary response to a system that values liberalised markets and *post facto* accountability. Other countries may seek to rein in some of the excesses, but there is a burden to ensure that a meaningful enforcement regime is in place, lest the desire for liberalisation lead to markets compromised not by burdensome regulation, but by fraud and consumer distrust.