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Will Aggregate Litigation Come to Europe?

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Will Aggregate Litigation Come to Europe?

Samuel Issacharoff[*] *& Geoffrey P. Miller*[**]

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The current wave of deregulation and market liberalization in Europe has had major repercussions for the prospect of litigated forms of collective redress. Once decried as the perversity of rapacious Americans, class actions are now the focus of significant reform efforts in many European countries and even at the level of the European Union. There are, no doubt, many reasons for the relatively sudden attention to means of collective redress. Some have to do with the need to create effective ex post accountability mechanisms to contain the potential adverse effects of goods and services freely entering the market. Others seek to create mechanisms for efficient resolution of

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the numerous intertwined claims that invariably arise from the mass production and delivery of goods and services across a broad market.

One should not gainsay the significance of these reform measures. All represent efforts to mobilize means of private enforcement to prevent harm through the prospect of civil litigation. For countries steeped in the civil law tradition, the move away from centralized public enforcement is a sea change in legal structures. The marriage of private enforcement mechanisms and relaxed barriers to entry into increasingly deregulated markets is a significant change as well. Add to that the diversity of litigation tools that are being developed and one would have to be almost churlish not to marvel at the liberalizing spirit sweeping the continent.

And, yet, one need spend only a few minutes in conversations with European reformers before the proverbial "but" enters the discourse: "But, of course, we shall not have American-style class actions." At this point, all participants nod sagely, confident that collective actions, representative actions, group actions, and a host of other aggregative arrangements can bring all the benefits of fair and efficient resolution to disputes without the dreaded world of American entrepreneurial lawyering. And no doubt the American entrepreneurial ways must and will be resisted fully, in much the same way that Europe has held off the unwelcome presence of McDonald's or Starbucks in its elegant piazzas. To this dignified and self-assured conversation we bring a simple but unwelcome question: Really?

We develop this Essay in two parts. First, we must acknowledge that the aversion to the American-style class action corresponds to sustained critiques of class actions in the United States as well. A number of American reforms, from revisions to the class action provisions of the Federal Rules of Civil Procedure to the Class Action Fairness Act, have taken aim at some of the misfirings of class actions. Some Supreme Court decisions, most notably *Amchem Products, Inc. v. Windsor*[1] and *Ortiz v. Fibreboard Corp.*,[2] have burdened class actions with procedural strictures that have limited the class action as an effective vehicle for resolution of mass personal injuries. Thus, in the United States, broad scale settlements of asbestos exposures or of pharmaceutical injuries are likely to take the form of bankruptcy workouts, or mass private aggregative

1. 521 U.S. 591 (1997) (decertifying class settlement of asbestos claims).
2. 527 U.S. 815, 830 (1999) (same).

settlements, as with the claims over harms caused by the anti-inflammatory drug, Vioxx.[3]

In this first Section, we examine four sources of claimed dissatisfaction with the class action to assess which are meritorious, which are ill-founded, and which derive from a deeper contest over whether or not there should be private legal accountability for low value or negative value consumer claims.

We then move on to draw certain conclusions from the American experience with collective actions to ask whether the proper incentives and institutional arrangements exist in the European reform efforts. Our aim here is not to advocate that American processes be adopted; neither of us sets foot in McDonald's or Starbucks when in Europe.[4] Rather, our inquiry is whether, based on some of the lessons that may be derived from both the American experience and the simple economics of incentive systems, the current European reforms are likely to be effective in realizing their stated aims. Our concern is that an apparent cultural revulsion at accepting the reality of legal enforcement as entrepreneurial activity may leave the reforms without the necessary agents of implementation.

I. WHITHER AMERICA

At some level, the striking feature of current developments in aggregative practices is the apparent convergence between significantly different legal systems.[5] Increasingly, the concerns over efficient use of the courts, limits on anticipatory regulation, and the cost barriers to consumer claims have all pushed toward broader experimentation with various forms of collective law enforcement. At the same time, the extent of American liberalization of private enforcement divides the continents. So, as American commentators, it is perhaps best for us to begin by acknowledging the serious critiques leveled domestically against American class actions and to ground the European aversion to excess Americanism in those debates.

We will not rehash the basic arguments about why collective means of aggregating claims are necessary. We have both addressed

3. The settlement agreement is available at http://www.merck.com/newsroom/vioxx/pdf/Settlement_Agreement.pdf (last visited Jan. 4, 2009).

4. One of us (Miller) confesses that he wishes to do so from time to time.

5. Richard Nagareda discusses this convergence in his Article in this volume. *See* Richard A. Nagareda, *Aggregate Litigation Across the Atlantic and the Future of American Exceptionalism*, 62 VAND. L. REV. 1 (2009).

these issues in many prior writings.[6] We both are deeply involved—one of us as a Reporter, the other as an Advisor—in the efforts of the American Law Institute to articulate the broader principles governing aggregate litigation. Instead, we want to address ourselves here to four distinct arguments raised in the American context over the further reaches, or perhaps excesses, of class-wide litigation.

Our focus will be on four features of class or aggregated litigation that are most at issue currently in the United States: first, the scope of settlement possible on a noncontractual basis; second, the limited nature of the recovery to potential class members; third, the uneasy relation between entrepreneurialism and avarice; and, finally, the manipulation of the judicial forum for litigation gain. We turn to each of these as an introduction to our assessment of European developments.

A. Mass Settlements

It is perhaps ironic that one of the features of American class actions that most appeals to foreign legal systems—the efficiency of mass resolution of common disputes—is also a source of problems at home. Consider for example, the current trial of alleged securities improprieties involving Deutsche Telekom,[7] the first test of the German Capital Markets Model Case Act.[8] The German statute allows a representative case the authority to obtain controlling legal principles for all similar claims. But the statute provides no mechanism for enforcing the judgment for the non-represented parties, and the law does not have any mechanism to create and adjudge any proposed collective resolution. Thus, even were liability to be determined in the test cases, there is no mechanism for the

6. *See, e.g.*, Samuel Issacharoff, *Group Litigation of Consumer Claims: Lessons of the American Experience*, 34 TEX. INT'L L.J. 135, 136 (1999) (discussing mechanisms for aggregating consumer claims); Samuel Issacharoff, *Regulating After the Fact*, 56 DEPAUL L. REV. 375, 380–81 (2007) (highlighting the effectiveness of class actions in compensating victims of securities fraud); Geoffrey P. Miller, *Class Actions*, *in* I NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 257–62 (Peter Newman ed., 1998) (explaining the economic rationale for class actions); Geoffrey P. Miller & Jonathan R. Macey, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 8–11 (1991) (same).

7. *See* DIETMAR BAETGE, CLASS ACTIONS, GROUP LITIGATION & OTHER FORMS OF COLLECTIVE LITIGATION—GERMANY 8–9 (2007), *available at* http://globalclassactions.stanford.edu/PDF/Germany_National_Report.pdf (summarizing the *Deutsche Telekom* case).

8. Kapitalanleger-Musterverfahrensgesetz [Act on the Initiation of Model Case Proceedings in Respect of Investors in the Capital Markets], Aug. 16, 2005, BGBl. I at 2437, *translated at* http://www.bmj.bund.de/kapmug; *see also* BAETGE, *supra* note 7, at 12–13 (describing procedures established by Model Case Act).

expeditious resolution of the remaining 16,000 claims of fraud.[9] At the other pole, the Dutch legislation that provides for enforceable class-wide settlements[10]—an Act whose sweep is similarly being tested at present in the proposed settlement of the non-U.S. claims in the Royal Dutch Shell securities fraud litigation[11]—enables private parties to impose a settlement without providing any corresponding mechanism for collective trial. From the U.S. perspective, this appears to be an invitation for weak agents to step forward as purveyors of suboptimal peace agreements.

In the U.S. context, however, the last three major Supreme Court decisions on class actions have all addressed the problematic further reaches of mass settlement. In *Matsushita Electrical Industrial Co. v. Epstein,* for example, the question was whether lawyers representing a state court class in a securities fraud case could agree to a class-wide settlement of federal securities claims over which the state court had no jurisdiction—a mismatch between the scope of settlement authority and representation for litigation, much as now arises under the Dutch class action statute.[12] Then, in *Amchem Products v. Windsor*, the Court struck down a sweeping asbestos settlement that would have exchanged compensation of current injured claimants for a structured workout of future claimants.[13] The latter group quite rightly exhibited "rational apathy," as well put by Professor Jack Coffee,[14] because the prospects of settlement were, for

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9. *See* BAETGE, *supra* note 7, at 13 (explaining that after an appellate court conducts the model case proceedings, a trial court decides all of the individual cases subject to the model ruling); Laurel J. Harbour & Marc E. Shelley, *The Emerging European Class Action: Expanding Multi-Party Litigation to a Shrinking World*, 18 PRAC. LITIGATOR 23, 29 (July 2007) ("Under the Capital Markets Act, claimants must opt in and each must file an individual lawsuit."); *Deutsch Telekom: Bad Connection*, ECONOMIST, Apr. 12, 2008, at 74, *available at* http://www.economist.com/business/displaystory.cfm?story_id=11021139 ("Even if the model plaintiffs are ultimately successful, all the other claimants must then sue separately in a lower court – a process which could take 20 years."); *see also* BAETGE, *supra* note 7, at 20 (noting that "investors who have joined model proceedings at a later stage or have not brought a suit at all are not bound by the model decision").

10. Burgerlijk Wetboek [BW] [Civil Code] arts. 3:305a–b; *see* IANIKA TZANKOVA & D.F. LUNSINGH SCHEURLEER, CLASS ACTIONS, GROUP LITIGATION AND OTHER FORMS OF COLLECTIVE LITIGATION DUTCH REPORT 7–9 (2007), *available at* http://www.law.stanford.edu/display/images/dynamic/events_media/Netherlands_National_Report.pdf (summarizing the main elements of the Dutch Act on Collective Settlements).

11. *See* Harbour & Shelley, *supra* note 9, at 28 (discussing collective settlement actions in the Netherlands); ShellSettlement.com, http://www.shellsettlement.com/ (last visited Jan. 4, 2009) (providing information related to the proposed settlement).

12. 516 U.S. 367, 369 (1996).

13. 521 U.S. 591, 628 (1997).

14. John C. Coffee, Jr., *Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation*, 100 COLUM. L. REV. 370, 422 (2000).

any particular individual at the time of settlement, a matter of remote discounted probabilities. Finally, in *Ortiz v. Fibreboard Corp.*, the Court refused to allow the limited assets of a litigation-crippled asbestos defendant to serve as the basis for a compelled workout of liabilities outside the formal structures of bankruptcy.[15]

The difficulty presented by each of these cases runs to the core of America's embrace of the notion of a private attorney general, a liberalized competition for the right to be an agent not selected by the principal. The difficulty in each of the three cases that reached the Supreme Court turned on the tension between principles of finality in settlement and the scope of the agency power of class counsel. None of the challenged settlement arrangements would have raised an eyebrow if negotiated by the principals themselves, or by counsel who were directly retained by and contractually subject to oversight by their clients. Parties acting on their own behalf are free to settle their private disputes without the formalities of actually filing suit over claims (the issue in *Matsushita*) or agreeing to anticipated damages for potential future claims (the stumbling blocks in the asbestos cases). The difficulty arises only when an unselected and effectively unsupervised agent settles on behalf of an absent class member.

American law responds to this tension in two ways, one formal and one a matter of intuition. The formal mechanism is to compel proposed class settlements into the strictures of the rules of procedure governing class actions. As recognized by the Court in *Amchem,* the fit is less than perfect.[16] The rules are structured to guide litigated disputes through the process of pleading, discovery, and trial. A consensual workout fits the formal rules structures poorly. Instead, in most class settlements, the Court retreats to what may be termed the "due process minima" first identified in *Phillips Petroleum Co. v. Shutts*.[17] This requires individual notice, an opportunity (in the case of damages actions) to exclude oneself from the binding class resolution through the opt-out process, and a guarantee of unconflicted representation. Where the amounts at stake are small or the prospect of future injury is remote, courts and commentators are skeptical whether these procedural protections amount to much at all.[18]

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15. 527 U.S. 815, 864–65 (1999).

16. 521 U.S. at 629 ("Rule 23, which must be interpreted with fidelity to the Rules Enabling Act and applied with the interests of absent class members in close view, cannot carry the large load [that the defendants], class counsel, and the District Court heaped upon it.").

17. 472 U.S. 797, 803 (1985).

18. *See, e.g.*, John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1535 (2006) (discussing the shortcomings of class actions in achieving compensation for plaintiffs).

Judicial intuition is a harder concept to define formally, but we believe it does some work. The key to the optimal class action is the principle of "if as to one, then as to all." No claimed broad-scale harm is likely to leave its victims in truly identical situations, but courts respond to the appearance of class members having basically fungible claims. In *Matsushita,* for example, there was no real difference between the shareholders who composed the class (except as to the quantum of their losses). The underlying claims all emerged from the same set of financial transactions, regardless of whether dressed up as state law or in federal garb. A common settlement not only comported with an intuitive understanding of the case, it seemed inevitable, regardless of the forum in which the action might have gone forward.

By contrast, the sweeping asbestos settlements gave the impression of the bill of peace being stretched beyond its obvious role. In *Amchem*, most notably, the class was made up of claimants with substantially different diseases, with claims against different manufacturers (and by extension insurers), with different future prognoses, and with wildly different sets of personal losses and suffering.[19] The integrity of mass resolution could neither be tested against a potential litigation of the claims (a poor test in any event given the paucity of trials generally in the American legal system[20]) nor by a representational structure attuned to the more striking differences among the represented claimants, most critically the present injured and the unknowing future victims.

Apart from any intuitive sense of the propriety of any particular mass settlement practice, the fact remains that the class action settlement scene appears dominated by class counsel offering to settle claims of those they do not represent. *Amchem* and *Ortiz* really only touched on the core problem in the context of the manifestly variegated classes of far-flung personal injury victims. But the same process repeats itself across the spectrum of cases involving only economic harms in the consumer, antitrust, and securities areas. Recent notable reforms to the role of the lead plaintiff under the Private Securities Litigation Reform Act and to Rule 23 have attended to the image of class counsel as itinerant purveyor of settlements.[21] But the issue remains very much alive in the American context.

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19. 521 U.S. at 624 ("No settlement class called to our attention is as sprawling as this one.").

20. *See generally* Marc Galanter, *The Vanishing Trial*, 1 J. EMPIRICAL LEGAL STUD. 459, 460–64 (2004) (discussing the declining number of trials in the United States).

21. *See, e.g.*, Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b) (2000) (establishing, inter alia, procedure for appointing lead plaintiff with most significant financial

B. Limited Recoveries

In virtually all class actions, the most significant recovery is by successful class counsel, not by any class member individually. Since attorneys are paid almost uniformly on a percentage of the common fund basis,[22] this is not only predictable, it is inevitable. Assume that attorney compensation in common fund class actions runs in the range of ten to thirty percent of the total class recovery. Just as a matter of simple mathematics, the only way a class member could recover on the same basis as counsel would be if a single class member had suffered between ten and thirty percent of the harm. Assuming the underlying claim to be the malfunctioning of a one hundred dollar widget, there would have to be a consumer who repeatedly bought the same widget to discover again and again that it did not work before this level of harm could be reached. We confess that our impulse would be to take this woe-begotten consumer ungently by the shoulders and ask, "Idiot, idiot, what were you thinking?"

Alternatively, it is argued that the recoveries in consumer cases are often sufficiently small that no rational person would ever pursue a claim for such amounts.[23] In such cases, class counsel are engaged in what the common law would have defined as the offense of barratry, the willful stirring up of legal disputes for purposes of profiting thereby.[24] The smaller the actual harm visited on any individual consumer, the more apparent the fact that the driving force behind the litigation has to be someone with an actual stake in its

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stake in the controversy); FED. R. CIV. P. 23(g) (establishing procedures for appointing class counsel); FED. R. CIV. P. 23(h) (establishing procedures for determining attorney fee awards).

22. *See* Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27, 28 (2004) (showing that regardless of formal compensation system, size of fund is best predictor of attorney compensation).

23. *See, e.g.*, Thomas Burch, *Necessity Never Made a Good Bargain: When Consumer Arbitration Agreements Prohibit Class Relief*, 31 FLA. ST. U. L. REV. 1005, 1027 (2004) (acknowledging the tendency for potential plaintiffs in consumer cases to be deterred from bringing meritorious claims for small recoveries).

24. Barratry is traditionally defined as the "offence of frequently exciting and stirring up suits and quarrels between [parties]." WILLIAM BLACKSTONE, 4 COMMENTARIES *134. A related offence, champerty, is the division of the proceeds from litigation between the party in interest and a financial backer of the litigation. It is defined historically as a bargain for the "maintenance" of a suit constituting "an officious intermeddling in a suit that no way belongs to one, by maintaining or assisting either party with money or otherwise, to prosecute or defend it." *Id.* Some jurisdictions in the United States have entirely abandoned the common law claims of champerty, maintenance, and barratry, in favor of laws governing contingency fees, misconduct, and the bringing of frivolous suits. *See, e.g.*, Saladini v. Righellis, 687 N.E.2d 1224, 1224, 1226–27 (Mass. 1997) (declining to recognize the doctrines of champerty, barratry, and maintenance); Osprey, Inc. v. Cabana L.P., 532 S.E.2d 269, 277–78 (S.C. 2000) (abolishing champerty as a defense).

outcome, someone who stands to be paid from the overall amount in controversy rather than any individual's recovery. In such cases, the principal-agent relationship that normally characterizes the roles of client and attorney is disrupted because the agent in effect creates the principal, or at least organizes the principal through collective representation.

To our minds, the only surprising thing about these related criticisms is that they are treated with any measure of surprise. The class action, as Judith Resnik aptly summarized it, is a state-created mechanism for subsidizing the litigation of claims that could not otherwise be justified.[25] The state in effect designates the agent, underwrites the cost of representation by removing the transactional barrier of having to contract with each client, and allows for a state-enforced taxation of the joint gains to compensate the agent. At least in the context of low-value claims, it is not only to be expected, it is necessary that the agent be paid much more than any individual might stand to recover. Otherwise, the transactional costs of litigation would make every sane consumer unwilling to pursue an individual claim.

Consequently, the charge that class actions allow claims into the legal system that would not otherwise be brought is curious, to say the least. Of course they do; indeed, that is the prime justification for a class action in the first place.

The more serious issue is why a legal system would encourage the prosecution of low-value claims that are unlikely to lead to much recovery by the affected class members. This opens up a much broader discussion about the role of deterrence, the importance of ex post mechanisms of accountability,[26] and the general trade-offs between public and private enforcement. These are matters that have been extensively explored elsewhere, including in our prior writings. Our point here, however, is a more limited one. To the extent that the law wants to harness private enforcement to deter (and secondarily to compensate for) the harms that typify mass consumer markets, there must be procedures that make such conduct not only feasible but financially remunerative as well. And, yet, the less-than-platonic interests of class counsel in profiting from their representation are a constant source of disparagement of American class actions.

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25. Judith Resnik, *Money Matters: Judicial Market Interventions Creating Subsidies and Awarding Fees and Costs in Individual and Aggregate Litigation*, 148 U. PA. L. REV. 2119, 2127–29 (2000).

26. For a more elaborate treatment of this issue, see Samuel Issacharoff, *Regulating After the Fact*, 56 DEPAUL L. REV. 375 (2007).

C. Corruption

The past year has seen the fall from grace of several of the leading plaintiffs' counsel in class representations. Amid the guilty pleas of the leading figures of the securities bar,[27] and a similar plea by perhaps the most well-known figure in the mass tort bar,[28] have followed less high-profile but equally disturbing indictments of lawyers charged with criminal misconduct in mass actions.[29] The facts and the severity of the conduct vary from case to case. But the inescapable impression is of a deeply corrupt set of practitioners called to justice. If we may conclude that where there is smoke, there must be fire, then surely where there is fire, there must be conflagration. Does this not lend credence to the fundamental error of American practice? Licensing entrepreneurial activity in search of bounties must surely lead to this form of misconduct—or at least so goes the argument.

No one should countenance criminal misconduct and the breach of some of the most solemn obligations shared by all lawyers. And, surely, there is *some* connection between the American use of the private attorney general and the capacity for this kind of misconduct. Entrepreneurial enterprises seek to harness the desire for self gain, and the line between invisible-hand style self-interest and avarice is a fine one indeed. The spate of current scandals in the United States comports well with European expectations, reinforcing their reluctance to license private lawyering in the service of collective redress.

Before becoming too enraptured with the perfidy of American love of self-interest as a motivator, however, a cautionary note: The question is always—compared to what? Most studies of regulatory behavior indicate that with the expansion of the centralized state

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27. Jonathan D. Glater, *Class-Action Lawyer Gets 30 Months in Prison*, N.Y. TIMES, June 3, 2008, at C3 (discussing plea deals of Melvyn I. Weiss and William S. Lerach for their roles in "concealing illegal kickbacks to plaintiffs").

28. Abha Bhattarai, *Class-Action Lawyer Given 5 Years in a Bribery Case*, N.Y. TIMES, June 28, 2008, at C3 (noting that Richard F. Scruggs, who gained fame for winning a multi-billion dollar settlement from the tobacco industry in the 1990s, was sentenced for attempting to bribe a Mississippi judge in a dispute over an insurance settlement arising out of Hurricane Katrina). Notably, the *New York Times* could not distinguish between court-supervised class actions, and private aggregations of individual cases – thus the reference to Richard Scruggs, a mass harm plaintiffs' lawyer, as a "class-action lawyer." *Id.*

29. *See, e.g.*, Julie Kay, *Asbestos Attorney Accepts 10-Year Term in Plea Deal*, DAILY BUS. REV. (Miami), Apr. 19, 2007, *available at* http://www.law.com/jsp/article.jsp?id=1176887061450 (noting that Miami attorney Louis Robles was indicted for "misappropriating $13.5 million in settlements").

comes an expansion of the gains to be had from political influence.[30] And with that expansion of state control comes a corresponding propensity toward corruption.[31] As one of the more comprehensive studies summarizes: "[H]eavier regulation of entry is generally associated with greater corruption and a larger unofficial economy, but not with better quality of private or public goods."[32] American entrepreneurial lawyering may yield misconduct; yet it is hardly as if the whiff of scandal has not reached countries more comfortably in the civil law tradition of state control. And, there can be no doubt that many of the more difficult features of American law turn on institutional arrangements such as the civil jury and elected judges, which have nothing to do with the forms of private enforcement.

Nonetheless, here again European concerns over some of the excesses of American lawyer-initiated mass actions correspond to concerns in the United States as well.

D. Magnets and Hellholes

The *Shutts* decision did more than simply set out the minimum due process constraints for the organization of a nationwide class action. In an opinion by then Justice Rehnquist, the Court looked to the class action as a quasi-administrative proceeding that could centralize comparably situated claims scattered across the country into one forum.[33] What *Shutts* did not address was the question of which was the proper forum for that centralization. That left open the possibility—soon realized—that cases of national scope, because of the undifferentiated movement of goods and services across the national market, could be brought anywhere that one aggrieved potential class member could be found. In practice, this meant that plaintiffs, as the first movers in litigation, could select any desirable forum for the litigation of claims of nationwide sweep.

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30. Alberto Ades & Rafael Di Tella, *National Champions and Corruption: Some Unpleasant Interventionist Arithmetic*, 107 ECON. J. 1023, 1025 (1997); Vito Tanzi, *Corruption Around the World: Causes, Consequences, Scope and Cures*, 45 INT'L MONETARY FUND STAFF PAPERS 559, 566–67 (1998).

31. Daron Acemoglu & Thierry Verdier, *The Choice between Market Failures and Corruption*, 90 AM. ECON. REV. 194, 194–95 (2000); Alicia Adsera et al., *Are You Being Served? Political Accountability and Quality of Government*, 19 J.L. ECON. & ORG. 445, 450 (2003); Simeon Djankov et al., *The Regulation of Entry*, 117 Q.J. ECON. 1, 35 (2002); Rafael La Porta et al., *The Quality of Government*, 15 J.L. ECON. & ORG. 222, 239 (1999); Andrei Shleifer & Robert W. Vishny, *Corruption*, 108 Q.J. ECON. 599, 600 (1993).

32. Djankov et al., *supra* note 31, at 35.

33. Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 809 (1985).

Cases of national scope quickly pointed to the frailty of a federal system.[34] The strength of a federal system is the diversity of responses to the common problems of social organization, what Justice Brandeis famously referred to as the "laboratories of democracy."[35] But Brandeis's premise was that each unit of federalist experimentation would be an autonomous enterprise whose relative merits and demerits would be observable. The post-*Shutts* world, however, allowed each local jurisdiction to test its experimental regime not within its geographic boundaries, but wherever similarly situated claimants might happen to be found.

The effect of *Shutts* was to liberalize the ability to coordinate a case of national scope into one forum, without providing any tools for resolving which forum that should be. Once we add differences in local rules governing aggregation, different legal cultures across the range of potential jurisdictions, the possibility of untoward influence with locally elected judges in some locales, and a range of other such experimental variables, the potential for strategic manipulation of forum becomes ever present. The results were repeated criticisms, some no doubt well founded, of certain choice places being a "magnet forum" or, less benignly, a "judicial hellhole" for the ensnared defendant.[36]

Leaving aside the problem of potential undue local influence or even corruption, the broader problem is the inevitable mismatch between locally based forms of judicial redress and markets that necessarily transcend local control. In the United States, the partial response has been to provide an expanded form of federal jurisdiction

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34. This Section is a pared down version of arguments more fully developed in Samuel Issacharoff & Catherine M. Sharkey, *Backdoor Federalization*, 53 UCLA L. REV. 1353 (2006), and Samuel Issacharoff & Richard A. Nagareda, *Class Settlements Under Attack,* 156 U. PA. L. REV. 1649 (2008).

35. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

36. As expressed in the legislative history of the Class Action Fairness Act:

> The reason for th[e] dramatic increase in state court class actions cannot be found in variations in class actions rules; after all, the rules governing the decision whether cases may proceed as class actions are basically the same in federal and state courts – and of course, they are the same within states, i.e., the same in "magnet" jurisdictions such as Madison County and St. Clair County, Illinois, as they are in more easily accessible jurisdictions such as Cook County, Illinois.

S. REP. NO. 109-14, at 13 (2005), *reprinted in* 2005 U.S.C.C.A.N. 3, 13; *see also id.* at 21 (discussing the filing of frivolous class actions); John H. Beisner & Jessica Davidson Miller, *They're Making a Federal Case Out of It . . . in State Court*, 25 HARV. J.L. & PUB. POL'Y 143, 155 (2001) (finding that "class action lawyers are bringing a large number of cases in a small number of state courts that have become 'magnets' for interstate class actions").

to allow nationwide cases to be brought into federal court[37] and, once there, to be consolidated for efficient pretrial development in one suitable federal court.[38] These mechanisms leave unresolved conflicts in state laws governing the distribution of identical goods and services along a national supply chain.[39] But they are at least attentive to the problem of multiple potential venues for the same alleged misconduct.

It does not take great foresight to anticipate that the same problem of rival prospects for aggregation might take root in Europe as well. The European experiment with federalism begins with independent nation-states, rather than the more limited American states. But the problem is made more acute because of the absence of European courts of first instance, the equivalent of the American federal court system. Since claims of aggregate harm are necessarily tried in the national courts, with national procedures, the tension between the EU's commitment to the free movement of goods and services and the local application of justice reproduces the American difficulties.

What unifies the four American controversies is precisely what most troubles Europeans about American class action practice: the role of private entrepreneurial lawyers. Each of the controversies in American practice returns to the issue of the incentives operating on lawyers who will predictably push the boundaries of the system. Yet, the simple fact is that lawyer initiative is the engine that fuels American aggregative practice. The question for reformers on both sides of the Atlantic is whether the endemic controversies that arise in a system built on self-interest can be mitigated without disabling the entire undertaking. In aphoristic terms, the question is very much one of throwing out the baby with the bathwater.

II. INCENTIVES, EUROPEAN-STYLE

Having looked at some of the flashpoints in American-style class actions, let us take a trip across the pond to Europe. Rules here are rapidly changing, and new proposals and recommendations are appearing at a dizzying rate. Analyzing European class actions is like

37. This is the effect of the Class Action Fairness Act of 2005 ("CAFA"), 28 U.S.C. §§ 1712–1715 (2000).

38. *See* 28 U.S.C. § 1407 (2000) (authorizing the Judicial Panel for Multidistrict Litigation to consolidate actions in federal courts "for the convenience of parties and witnesses and [to] promote the just and efficient conduct of such actions").

39. *See* Samuel Issacharoff, *Settled Expectation in a World of Unsettled Law: Choice of Law after the Class Action Fairness Act*, 106 COLUM. L. REV. 1839, 1840–44 (2006) (examining conflicts of law in national market cases).

shooting at a moving target. Each country is also unique, with its own legal culture, history, constitution, political system, court system, and rules governing the legal profession. It is risky, therefore, to attempt a detailed analysis of any particular country's venture into class actions, especially given our lack of detailed knowledge of any particular European system. What we can do is examine certain features that commonly appear in the European setting without suggesting that these features appear in every country or that our stylized and general description of these features accurately reflects the detailed law of any particular country.[40]

Three features in particular stand out: (1) the tendency to allow only organizations to represent consumers in class action cases, (2) the interaction between rules on litigation funding and class action procedures, and (3) the preference for "opt-in" as opposed to "opt-out" systems.

A. Organizational Standing

Class action procedures in Europe often restrict lead plaintiff rights to organizations that represent consumer interests.[41] This approach contrasts with that of the United States, where any class member can seek to represent the class. It is not necessary in the United States for the class representative to be an organization. All that is required is that the candidate demonstrates that he will provide adequate representation and that his claims are typical of the claims of other class members.[42]

Rules limiting the lead plaintiff role to consumer organizations or similar groups appear designed to serve four objectives. First, like

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40. Class action procedures obviously vary across European countries. For a useful country-by-country table summarizing major recent developments in aggregate litigation in Europe, see Nagareda, *supra* note 5, at 21–25. For more extensive comparative analysis of current European law, see JULES STUYCK ET AL., AN ANALYSIS AND EVALUATION OF ALTERNATIVE MEANS OF CONSUMER REDRESS OTHER THAN REDRESS THROUGH ORDINARY JUDICIAL PROCEEDINGS (2007), http://ec.europa.eu/consumers/redress/reports_studies/comparative_report_en.pdf; *see also* RACHAEL MULHERON, REFORM OF COLLECTIVE REDRESS IN ENGLAND AND WALES: A PERSPECTIVE OF NEED 79–120 (2008), http://www.civiljusticecouncil.gov.uk/files/collective_redress.pdf.

41. *See* Fabrizio Cafaggi & Hans-W. Micklitz, *Collective Enforcement of Consumer Law: A Framework for Comparative Assessment*, 16 EUR. REV. PRIVATE L. 391, 417 (2008) ("The majority of Member States in Europe start from the premise that consumer organizations should be given a role in administrative and/or in judicial enforcement."); Harbour & Shelley, *supra* note 9, at 28 (discussing approaches of Spain and the Netherlands). A recent exception is Spain, which does not restrict lead plaintiff rights solely to organizations – groups of individuals acting through a single lawyer can also maintain group actions.

42. *See* FED. R. CIV. P. 23(a) (listing the prerequisites for class actions). Additional requirements apply in securities fraud cases, as we will discuss below.

the requirements of typicality and adequacy under U.S. law, these rules select as the class representative a party who is expected to provide competent and loyal services to absent class members. Second, rules on organizational standing try to ensure that the class representative has the resources to pay the expenses of the case under prevailing rules on litigation funding. Third, these rules seek to thwart the emergence of American-style entrepreneurial class action attorneys. Fourth, and finally, there may be a jurisprudential element in organizational standing: the idea—often vaguely conceptualized—that the temporary authorization of a random individual to represent a class is simply an insufficient basis for the court to take cognizance of the interest of absent parties. Something more substantial, such as a preexisting relationship with an established group, may be needed. We will look at each of these justifications.

The last concern—jurisprudential problems with individual class members acting as lead plaintiffs—should not detain us long. All countries, as far as we know, recognize that people can be authorized to act on behalf of others. This is why the law of agency exists. There should be nothing in any well-developed legal system that prevents a court, if authorized by law and otherwise empowered to adjudicate a case, from appointing a party to represent the interests of others not present before the court.

The other three concerns, however, require more detailed investigation. In this Section we will examine two of the justifications, deferring for the next Section the investigation of whether organizations are better able to fund class action litigation.

So, will consumer organizations provide competent services to the class? The answer is probably a qualified "yes." Of course, merely having the status of a consumer organization does not mean that the people who work in the organization actually know how to manage lawsuits. Regardless of the title, an organization might be incompetent at the task, in which case the organization will not be a good class representative. But we can assume that organizations that purport to represent consumers usually have at least some expertise in enforcing consumers' legal rights. Moreover, the courts that appoint these organizations as lead plaintiffs should have discretion to assess whether the candidates for the position have the qualifications to do the work. On this score, organizational standing appears superior to the more liberal standing rules under U.S. class action practice, where the courts, especially in consumer cases, routinely accept class

representatives whose understanding of the case can be charitably described as minimal.[43]

Even if they are competent, will consumer organizations provide loyal service to the class? Will they act as faithful fiduciaries of class interests?[44] Here the analysis is more qualified. We may assume that consumer organizations are staffed by people who conceive of themselves as dedicated to the cause of consumer protection. But even dedicated and idealistic people may not act as faithful champions when their guiding principles do not overlap with the interests of those they are assigned to represent.

The loyalty of consumer organizations to class member interests depends, to an extent, on a legal issue: Are the organizations in question entitled under a given country's law to sue on behalf of *all* consumers, or is their representational status limited to their own *membership*?[45] If the organization can sue on behalf of all consumers, whether or not they are members of the organization, substantial agency problems can arise. The interests of nonprofit consumer organizations may reflect ideological considerations that may not necessarily coincide with the economic interests of consumers. Suppose, for example, that an organization empowered to act as a class representative is committed to environmental protection—a noble aspiration, but not one necessarily consonant with the interests of a class of consumers who desire competitively priced products. If this organization selects cases and litigation strategy on the basis of environmental considerations—going easy, let's say, on companies that donate money to Greenpeace while vigorously pursuing companies that produce genetically modified crops—the enforcement of consumer interests would be skewed in ways that do not necessarily reflect the interests of consumers as a whole, who might prefer cheaper prices to greener products. This potential for distorted representation as a result of a distinct policy agenda is not as worrisome in U.S. class action litigation, where the class is usually represented by attorneys whose interests are in obtaining a fee, not in changing the world.

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43. *See* Geoffrey P. Miller, *Competing Bids in Class Action Settlements*, 31 HOFSTRA L. REV. 633, 634 & n.2 (2003) (citing literature indicating that "representative plaintiffs are usually mere eponyms").

44. For a perceptive analysis stressing the problems of accountability for consumer organizations, see Cafaggi & Micklitz, *supra* note 41, at 391 ("Consumer associations empowered with enforcement need to become more accountable towards members and the general public.").

45. Harbour & Shelley, *supra* note 9, at 28 (noting that Spain permits consumer organizations to bring actions on behalf of both their membership and unidentified victims).

This problem of ideological distortion is mitigated if many consumer organizations with different viewpoints are qualified to act as class representatives. When lots of organizations are available, the decision by one organization not to bring a case for ideological reasons doesn't prevent the case from being litigated by some *other* organization that may have different beliefs. The problem is not entirely solved, however. People with strong views tend to exercise disproportionate influence in voluntary organizations. Even when many organizations are qualified to act as class representatives, therefore, the consumer interest may not be fully represented. In such an environment, valid consumer cases may not be brought simply because no organization feels it desirable to do so.[46] Even when cases *are* brought, moreover, the organization given lead plaintiff status may elect to litigate the case through the perspective of its special concerns. For example, the class representative might settle a case in exchange for changes in business practices which address the organization's interests, but which do not provide effective relief for consumers.

These concerns about ideological activities of consumer organizations are not as troubling if an organization is permitted only to represent its *own* members rather than all persons injured by the challenged product or practice. People who join an organization usually endorse its stance on public issues. They are not prejudiced if the organization makes litigation decisions based on ideological factors with which they agree. But the problem of fidelity to consumer interests is only partially addressed when an organization is limited to representing its own members. If injunctive relief is permitted, for example, the organization may seek changes in the defendant's practices which serve the interests of the organization and its members, but which do not serve the interests of others. Moreover, if organizations represent only their own members, some consumers may receive no representation at all—an even worse outcome than if they receive representation that is only partially faithful to their interests.

Other problems of loyalty may be presented aside from ideological distortion of litigation decisions. There is always the risk,

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46. In the United States, for example, class actions have been brought against a company that manufactures chewing tobacco, claiming that the defendant illegally manipulated the market in this product. *E.g.*, *In re* Mass. Smokeless Tobacco Litig., No. 03-5038-BLS1 (Mass. Sup. Ct. Apr. 7, 2008). Because chewing tobacco is often considered to be a dangerous product, one could imagine that no consumer organization would take this case because the result, if the case succeeded, is that chewing tobacco would be cheaper and easier to obtain. One of us (Miller) has acted as an expert witness in a number of these cases.

for example, that managers will not act as faithful agents of their organizations. Managers may misappropriate funds, pay themselves excessive salaries, appoint family or friends to jobs in the organization, or simply take too many holidays. These sorts of conflicts of interest may detract from the organization's ability to represent class members. The organization's role as lead counsel creates still other opportunities for managers to place personal gain over the interests of their institutions. If the organization has the power to allocate lucrative legal work, for example, there may be fruitful opportunities for referral fees from the law firms that receive these assignments.

These problems with organizational standing do not necessarily imply that European organizational standing rules are inferior to the American approach. All organizations face agency costs. The challenge for legal design is to find a structure of rights, duties, and incentives that delivers the best package overall. If consumer organizations do manifest the problems described, moreover, the courts and legislatures will doubtless seek ways to deal with them. The question is whether organizational standing offers the best approach to protecting consumer interests or whether some other approach would be superior.

The next issue is whether consumer organizations will be able to avoid being captured by entrepreneurial attorneys. Assuming for present purposes that entrepreneurial attorneys are bad for class action litigation—a topic investigated in Part I—the question is, will consumer organizations prevent this blight from springing up in Europe? American experience is instructive here. The Private Securities Litigation Reform Act ("PSLRA"), a statute enacted in 1995, assigns lead plaintiff rights in federal securities fraud cases to the class member with the most significant stake in the controversy.[47] The purpose was to bring entrepreneurial attorneys to heel.[48] The lead plaintiff rules were intended to insert an active, sophisticated party with a genuine stake in the controversy as the champion of class interests, in order to counterbalance the power of self-interested plaintiffs' firms.[49]

These rules have changed securities litigation in the United States, in that the plaintiffs in these cases today are often

47. 15 U.S.C. § 78u-4 (2000).

48. H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.) (noting "abusive practices committed in private securities litigation," including "routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer").

49. *Id.* at 34–35.

institutional investors with significant amounts at stake. Institutional investors appear to exercise somewhat more control over class counsel than the individual plaintiffs who served as class representatives before the PSLRA was enacted.[50] There is even evidence that attorneys' fees are lower when institutional investors act as lead plaintiffs.[51] Overall, however, the lead plaintiff rules have not significantly changed the environment. The same firms that dominated class action litigation prior to 1995 control it today (although some attorneys have departed for other reasons).[52] Entrepreneurial attorneys continue to dominate securities class action practice today as they did in prior years.[53]

The U.S. experience suggests that the selection of consumer organizations to act as class champions may not, in and of itself, prevent class litigation from being dominated by self-interested attorneys. It is possible that attorneys may form their own consumer organizations with a view towards awarding themselves the right to litigate cases entrusted to these entities. Even if the organization is formally independent, attorneys interested in obtaining fees may find many ways to obtain influence. The allocation of control over cases under European organizational standing rules will predictably depend on matters such as the stature and funding of the organization; its financial stake in the litigation; the source of funding for class counsel; the power, prestige, and qualifications of counsel; and the relationship between counsel and the management of the organization.

B. Litigation Funding

In law, as in life, it is dangerous to make an unqualified statement for fear of immediate refutation. But one thing seems certain: there are no societies where lawyers work for free. As the fool puts it in *King Lear*, worthless words are "like the breath of an unfeed lawyer—you gave me nothing for't"[54] It can safely be said that none of

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50. *See* Michael A. Perino, *Institutional Activism through Litigation: An Empirical Assessment of Public Pension Fund Participation in Securities Class Actions* 1 (St. John's Univ. Sch. of Law Legal Stud. Research Paper Series, Paper No. 06-0055, 2006), *available at* http://papers.ssrn.com/abstract=938722.

51. *Id.*

52. *See* Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1489 (2006) (finding that "individual law firms' market shares . . . suffered no appreciable change in the wake of the PSLRA").

53. *See id.* (finding that "few plaintiff law firms either entered or exited the market after the enactment of the PSLRA").

54. WILLIAM SHAKESPEARE, KING LEAR act I, sc. 4.

the class action procedures adopted or proposed across Europe in recent years will succeed if they fail to compensate counsel adequately. This is not a controversial point. Others more familiar with the European legal landscape have made the same observation.[55] But carrying that recommendation into reality, in the context of European legal systems, can be a challenging task.

Two rules commonly found in European procedure present problems for class actions. First is the prohibition on contingency fees. This rule is beginning to break down; for example, the German Constitutional Court recently ruled that the ban on contingency fees unconstitutionally burdens clients' rights of access to the courts and attorneys' rights to practice their profession.[56] England and Wales also permit a form of contingency fees, and the concept appears to be gaining momentum elsewhere.[57] But where the ban on contingency fees remains in effect—and this seems to be many places—the consequences for class action litigation are significant.

The contingency fee permits the attorney to fund the litigation and thus overcomes problems of liquidity that may make it impossible for an individual to pursue his rights. Attorneys are good litigation funders. As legal specialists, they have the ability to assess the value of suits. They will thus tend to direct valuable resources (their time and energy) to cases that offer the largest expected benefit for class members and society as a whole. Because attorneys handle numerous lawsuits, moreover, they can achieve portfolio diversification in ways not possible for ordinary clients, who are usually involved in only one. And attorneys tend to have better liquidity than consumers. They finance cases through their own efforts. If bank financing is required,

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55. *See* Cafaggi & Micklitz, *supra* note 41, at 391 ("Pecuniary and non-pecuniary incentives need to be provided for plaintiffs' lawyers. These may not be only market driven, but also public policy oriented, thus affecting the selection of claims to be litigated.").

56. Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Dec. 12, 2006, Entscheidungen des Bundesverfassungsgerichts [BverfGE] 1 BvR 2576/04, *available at* http://www.bverfg.de/entscheidungen/rs20061212_1bvr257604.html.

57. Since the 1990s, England and Wales have allowed the conditional fee model, which takes two forms: a "no win no fee" agreement and an uplifted fee if the case is successful. In either case, the size of the increased fee is independent of the award or settlement in the case. CHRISTOPHER HODGES, GLOBAL CLASS ACTIONS PROJECT COUNTRY REPORT: ENGLAND AND WALES 27–28 (2007), *available at* http://globalclassactions.stanford.edu/PDF/England_Legislation.pdf. Other European nations have experimented with, or are considering, introducing this system of financing litigation. Winand Emons, *Conditional Versus Contingent Fees*, 59 OXFORD ECON. PAPERS 89, 89–90 (2007). For a detailed history of the adoption of the conditional fee system in England, see Richard L. Abel, *An American Hamburger Stand in St. Paul's Cathedral: Replacing Legal Aid with Conditional Fees in English Personal Injury Litigation*, 51 DEPAUL L. REV. 253, 253–57 (2001) (outlining the history of and policy behind the adoption of contingent fees in England).

they are probably better than their clients at obtaining loans at favorable rates. Accordingly, the contingent fee can generate effective funding of class action litigation. Essentially all U.S. class actions are funded with contingent fees.

It is difficult, however, to design an effective class action procedure in the absence of a contingent fee. Consider the case where the law imposes on an individual plaintiff the responsibility to pay the expenses of litigation with no right of contribution from other class members, as under the German representative action for securities improprieties. Under these conditions, the plaintiff faces the following payoffs: if the case succeeds, receive his or her share of the class recovery (which may be only a few euros); if the case fails, pay not only the class attorneys' fees, but the defendant's fee as well. No rational individual would be willing to serve as class representative in these conditions.

A few jurisdictions have experimented with litigation funding corporations as a means for capitalizing class action litigation. The concept is perhaps best developed in Australia, where several such firms are in operation; one is even listed on the Australian Stock Exchange.[58] These organizations, which also operate in Canada, advance funds for the litigation and provide indemnities against possible liability for fees in exchange for a cut of the proceeds if the plaintiffs succeed.[59] Such organizations do not appear to have caught on to any substantial extent in Europe. Litigation funding companies are an innovative solution to the funding problem. At bottom, however, they appear to rely on rules for allocating litigation proceeds that are functionally similar to the contingent fee.

Another alternative to the litigation funding dilemma is to use organizations as representative plaintiffs. The advantage of these parties is that they may have a budget to cover the costs of consumer suits and therefore may not be as liquidity constrained as the average consumer. Even so, organizations are likely to face difficulty in funding class action litigation in the absence of a contingent fee. Money does not materialize out of the sky. Who will fund the organizations?

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58. *See* IMF (Australia) Ltd Home Page, http://www.imf.com.au/ ("IMF is a publicly listed company providing funding of legal claims and other related services where the claim size is over $2 million.") (last visited Jan. 4, 2009).

59. The Australian Supreme Court upheld such arrangements against the claim that they violate rules against champerty and maintenance. *See* Campbells Cash & Carry Pty Ltd. v. Fostif Pty Ltd. (2006) 229 A.L.R. 58, *available at* http://www.austlii.edu.au/au/cases/cth/HCA/2006/41.html ("By 'organising' persons into a legal action for the vindication of their legal rights, representative proceedings are not creating controversies that did not exist.").

Under traditional rules, it appears that an organization could not get funding from the case itself.[60] If a case succeeds, the benefits of the judgment go to class members rather than to the organization. If a case fails, a representative organization has to pay both its attorneys' fees and the defendants' attorneys' fees. This is a losing proposition overall; the organization either gains nothing or loses a lot. The rules could of course be adjusted to allow organizations to collect a share of the proceeds of successful cases prior to the payments to class members. If these payments are large enough to compensate for the costs of cases that fail, they can make these organizations financially viable without other funding. But allowing the organizations to take a share of the class recovery is nothing other than a contingent fee by another name.

If organizations are not funded from the proceeds of successful cases, they must find other sources of support. Class members are an obvious possibility. But obtaining payment from class members is fraught with difficulty.

Obtaining payment after the fact, in the absence of a prior agreement, would appear all but impossible. Many class members would probably refuse an organization's request that they share the benefits of a judgment if the case succeeds. They are even less likely to want to share the costs if the case fails.[61] Even if, under applicable law, a class member's decision to opt in to a case obligates him to pay his share of the expenses if the case fails, an organization that fronts such expenditures may face allegations that it did not properly inform class members of the risks of opting in. It could be difficult for the representative plaintiff to pursue class members for payment in this situation.

Perhaps such organizations could condition membership on payment of dues. With the money in hand, the organizations would not face the challenge of collecting it post hoc. But dues paid in advance also present difficulties. If the consumer organizations

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60. *Cf.* KATHLEEN M. SULLIVAN & GERALD GUNTHER, CONSTITUTIONAL LAW 64 (15th ed. 2004) ("Third-party standing is thus more likely to be allowed the closer the relationship and the greater the identity of interest with the rightholder . . . .").

61. One such case famously occurred in the United States. *See* Kamilewicz v. Bank of Boston Corp., 100 F.3d 1348, 1349 (7th Cir. 1996) (involving a class action settlement case in which class members were paid a settlement award, but after the attorneys' fees for obtaining the settlement were deducted from their award, many class members yielded a net loss). Subsequently Congress banned the practice under the Class Action Fairness Act. *See* 28 U.S.C. § 1713 (2000) (allowing court to "approve a proposed settlement under which any class member is obligated to pay sums to class counsel that would result in a net loss to the class member only if the court makes a written finding that nonmonetary benefits to the class member substantially outweigh the monetary loss").

represent everyone who is harmed by a defendant's conduct, rather than just its membership, severe free rider problems arise. Consumers would be better off not joining the organization and getting its services for free. Even if the consumer organizations represent only their members, organizations would have to charge dues sufficiently high to compensate for anticipated litigation expenses. It is not clear that consumers would be willing to pay these costs in advance when the return on their investment is only the hope that they might someday share in the recovery from a lawsuit. Consumer resistance to paying dues in advance could be avoided if organizations conditioned membership on taking a cut of the recovery if the case succeeds. But again, this strategy is nothing more than a contingent fee under another name.[62]

The other alternative for funding class action litigation appears to be the government. Certainly the government has the necessary resources. And because consumer class actions are brought on behalf of large segments of the public, the argument in favor of public funding is substantial. Yet government funding is not a panacea. If organizations are funded by public authorities, their survival becomes captive to politics. Funding is never certain, and in times of austerity consumer organizations may find that their budgets are among the first to be slashed. Moreover, the principle of "he who pays the piper calls the tune" is likely to operate in the case of government funding. Politicians may seek to influence the organization's behavior. Pursuit of particular cases may be encouraged or discouraged by politicians who wish to punish enemies or reward friends. In short, the independence of consumer groups cannot be guaranteed if they rely on public funding for their operations.[63]

Some of the funding problems associated with the lack of a contingent fee could be alleviated if the "loser-pays" rules are reformed to make the consequences less draconian. For example, in consumer cases, the rule could be transformed into a "one-way" fee shifting system, under which the defendant must pay counsel fees if the class succeeds, but the class does not have to pay the defendant's fees if the

62. Free rider problems can also be problematic. If the consumer organization is allowed to seek compensation for all injured consumers, not just those who are members of the organization, then consumers would lose the incentive to join the organization in the first place because by doing so they would be subsidizing class members who did not join.

63. The opposite problem may also be present. If an organization has strong views on controversial topics, the provision of government funding could represent a potentially troublesome subsidy by the government of private ideological activism.

case fails.[64] Eliminating class members' risk of liability could enhance their willingness to participate in cases. Such proposals, however, can be expected to be resisted by business interests, who may perceive them as unfairly one-sided. Even if adopted, moreover, they would not fully address the funding problem. Although they eliminate one cost of litigation—the obligation to pay the defendant's fee if the case fails—they do not eliminate another cost, namely, the obligation to pay class counsel if the case fails. Unless a practicable means is found to pay this cost, one-way attorneys' fees rules will not fully address the funding problem for class action litigation.

C. Opt-in Versus Opt-out Procedures

A third notable feature of several European class action procedures is that they utilize opt-in rather than opt-out mechanisms (the recent Italian statute is an example).[65] No doubt, such opt-in procedures have advantages. They ensure that class members join litigation out of their own free will—in marked contrast with the opt-out process, under which it is possible for a class member to be a part of a lawsuit and suffer a preclusive judgment without any knowledge. Opt-in procedures also respect the jurisprudential idea that litigation cannot be legitimate, as regards an innocent party, unless he has voluntarily agreed to join the action.

But opt-in procedures also pose problems. We will discuss three of these difficulties: problems with incentivizing a named plaintiff under an opt-in regime, difficulties in attracting adequate participation rates, and the challenge of offering defendants the opportunity to achieve global peace through the class procedure. We then turn to the relation between the choice of opt-in or opt-out rules on the objectives of deterrence and risk internalization that underlie a system of after-the-fact liability for wrongful conduct.

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64. Quebec has apparently come close to this approach by limiting class members' liability to nominal costs. Garry D. Watson, *Class Actions: The Canadian Experience*, 11 DUKE J. COMP. & INT'L L. 269, 274 (2001). Ontario has established a public corporation charged with reimbursing unsuccessful lead plaintiffs for cost obligations. *Id*. at 274–75.

65. Legislative Decree, Sept. 6, 2005, No. 206, art. 139 (Italy), *available at* http://www.sviluppoeconomico.gov.it/pdf_upload/documenti/phphBdUES.pdf; Stefano Capiello, *Supervision and Class Action Against Conflicts of Interest in Universal Banking: The U.S. Experience vis-à-vis Recent Italian Initiatives* 21–25 (N.Y.U. Hauser Global Law Working Series, Paper No. 03/2007, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=949896.

1. Who Will Step Forward?

Opt-in procedures can create complicated strategic dynamics that can impede or prevent the successful protection of consumer rights. In particular, they can create a barrier for anyone to step forward as the representative plaintiff—a feature that has hampered the application of the new Capital Markets Model Case Act in Germany, for example.[66] So long as there are collective gains to be had from being a passive party in a representative action, and so long as that is coupled with the risk of suffering losses if one is the representative party, the overwhelming temptation will be to remain a passive free rider. The losses are of two forms. The simpler is the loss that comes from actually being a party to losing litigation. The disparity between the loss that the representative party may face and the risks of the other potential claimants can be mitigated by expanding the preclusive effect of a representative judgment that the individual may realize—a practice that appears to be gaining favor in England and Wales under Group Litigation Orders. But the deeper problem is that, so long as there is a loser-pays rule, the named claimant in the representative action is being asked to assume the entirety of the risks associated with a failed venture, while delivering a common good to the other claimants if successful. Whenever there is such a marked disparity between concentrated risks and diffuse benefits, the temptation to free ride is dramatic. And, in the absence of a coordination mechanism on cost exposure, one would expect the classic form of failure associated with collective action problems.

2. Insufficient Participation

American experience suggests that the opt-in procedure will face difficulty in attracting widespread participation. The reason is inertia. Experience under American opt-out rules confirms that class members usually do nothing. They almost never opt out. In consumer cases, on average, less than .2 percent—two in a thousand—exercise the right to exclude themselves from the case.[67]

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66. DIETMAR BAETGE, CLASS ACTIONS, GROUP LITIGATION & OTHER FORMS OF COLLECTIVE LITIGATION: GERMANY 31 (2007), *available at* http://globalclassactions.stanford.edu/PDF/Germany_National_Report.pdf.

67. *See* Theodore Eisenberg & Geoffrey Miller, *The Role of Opt-Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues*, 57 VAND. L. REV. 1529, 1532 (2004) (deriving this figure from a study examining several thousand class action decisions between 1993 and 2003).

Opt-out rates are somewhat informative about probable participation under European opt-in procedures, but they need to be evaluated with caution because of a significant difference between the contexts. In the case of opt-outs, the path of inertia—doing nothing—is also the path of rationality. It is nearly always in the class member's interest not to opt out of class cases. If the class member opts out, he gains virtually nothing but loses the right to participate in whatever benefit the class litigation may generate—a small benefit, perhaps, but still one that confers some value. Conversely, if the class member does nothing, he loses nothing other than an essentially worthless right to bring his own lawsuit, but he gains the right to participate in the proceeds of the litigation. A rational class member will not opt out.

The incentives are otherwise with the opt-in decision. Here, rationality counsels class members to opt in. If the class member opts in, he gets to participate in whatever value the class action may generate, whereas if he fails to opt in, he forfeits the right to participate in the class case and gains only the essentially worthless right to bring his own individual action. In opt-in cases, the path of rationality is to act rather than to do nothing. Thus the behavior of class members in opt-out cases, where inertia and rationality coincide, will not necessarily carry over to opt-out cases, where they conflict.

A more direct analogue to European opt-in statutes is found in three American statutes that use opt-in rather than opt-out procedures: the Age Discrimination in Employment Act,[68] the Fair Labor Standards Act,[69] and the Equal Pay Act.[70] Evidence from reported cases suggests that participation rates under these statutes are around fifty percent.[71] Although not as high as they might be if class members behaved rationally, such participation rates are not at all bad. But we should not readily conclude that consumer class actions in European opt-in regimes will have similar participation rates. American opt-in statutes apply in the specialized context of workplace litigation. Cases brought under these laws typically involve only a small number of plaintiffs; the class members have many

68. Age Discrimination in Employment Act of 1967, 29 U.S.C. § 626(b) (2000) (establishing the opt-in requirement for ADEA).

69. Fair Labor Standards Act of 1938, 29 U.S.C. § 216(b) (2000) (establishing the opt-in requirement for FLSA).

70. Equal Pay Act of 1963, 29 U.S.C. § 206(d) (2000) (establishing that the EPA is subject to the opt-in provisions of 29 U.S.C. § 216(b)).

71. *See, e.g.*, Su v. Elec. Arts, Inc., No. 6:05-cv-131-Orl-28JGG, 2006 WL 4792780, at *1 (M.D. Fla. Aug. 29, 2006) (finding 76 members out of 110 members in the class joined FLSA class action); Lenahan v. Sears, Roebuck & Co., Civ. No. 02-0045, 2006 WL 2085282, at *13 (D.N.J. July 24, 2006) (finding 7500 of 16,252 class members joined FLSA class action).

opportunities to communicate with one another about the litigation, both at the workplace and via electronic means such as the Internet; and the amounts recovered are often substantial. All these factors tend to increase participation rates. Where these factors are absent—as in the typical consumer case, where class members have nothing in common other than that they all purchased a particular product—participation rates can be expected to be considerably lower.

An even closer American analogue to European opt-in procedures might be found in class action settlements. U.S. class action cases often settle, and when they do, class members who have not opted out are usually required to submit claim forms establishing their entitlement to relief. If they do not file claims they get nothing. The claiming process after settlement of an opt-out case is thus functionally similar to the opt-in process under European statutes. If anything, in fact, the incentive to claim, post-settlement, is greater in opt-out cases than in opt-in cases; failing to file a claim forfeits all right to recovery, whereas failing to opt in only forfeits the right to participate in the action before the court.

Claim rates depend on factors such as the size of per capita recovery, the extent of the notice program, the ease of filing a claim, and the degree of outreach undertaken by class counsel. Overall, however, the American experience is mixed. Cox and Thomas studied claiming rates in securities cases and found that even highly sophisticated institutional investors often fail to claim the settlement benefits. Less than thirty percent of the institutional investors with demonstrated entitlement to relief filed claims, even though failing to do so left billions of dollars on the table.[72] This study, moreover, dealt with securities cases with sophisticated parties and significant amounts at stake. Claiming rates in consumer cases are often even lower—not a surprising fact given that the parties are less sophisticated and the recoveries tend to be small. Some documented consumer claim rates have been in the single digits, and in one case not a single class member filed a claim, even though the class consisted of more than a million people.[73]

Based on this experience, what levels of participation can be expected in European opt-in cases? An important factor here will be the scope of consumer organization standing. If the scope of

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72. James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 412 (2005).

73. Nienaber v. Citibank (South Dakota) N.A., No. Civ. 04-4054, 2007 WL 752297, at *2 (D.S.D. Mar. 7, 2007).

representation is limited to the organization's members, opt-in rates can be anticipated to be relatively high, because by joining an organization, people signal their willingness to participate in its activities. Moreover, it might be possible, under the law of some jurisdictions, for the consumer organizations to obtain advance agreements from their members to participate in all applicable class action litigation brought by the organizations in the future. If such agreements were respected, participation rates could come to resemble the U.S. style opt-out procedure, although all the opt-ins would be members of the organization. If the scope of representation extends more broadly to all consumers damaged by the defendant's conduct, however, opt-in rates are likely to be much lower, and probably in line with U.S. experience for claiming rates in settlements.

Overall, for the opt-in process to render effective relief, it will be crucial for jurisdictions implementing it to provide effective means for participation. For example, such means could take the form of clear notice (ideally, in consumer cases, including telephone information lines and web pages as well as written notice); cheap and easy opt-in forms (again including web-based sign-up mechanisms); and outreach by the representative plaintiff coupled with suitable incentives for that party to maximize participation rates.

3. Insufficient Finality

Let's turn now to the question of whether opt-in procedures can accomplish global peace (global, that is, in the small world of a consumer dispute). U.S. experience indicates that defendants desire to extinguish all liability when they settle a class action. That desire is expressed in clauses, demanded by defendants, which declare the entire agreement to be null and void if more than a specified number of plaintiffs opt out of the litigation. The goal of global peace also indirectly benefits members of the class because defendants will pay more for settlements that offer assurances against future litigation.

Compared with opt-out procedures, the opt-in requirement offers significantly less assurances against continued litigation. In an opt-out environment, anyone who doesn't exclude himself is bound by the outcome and cannot participate in future litigation within the scope of the release or judgment. In an opt-in environment, only those who affirmatively join the litigation are bound by the outcome; everyone else is free to bring additional lawsuits. The defendant obtains no protection against these claims. Moreover, the threat of additional lawsuits is not merely theoretical. If only a small

percentage of the class opts in to a class action, it may be possible for another class action to be brought on behalf of those who did not opt in.[74] This problem with lack of global peace is illustrated in the current Deutsch Telekom litigation in Germany. Should Deutsch Telekom lose on a determination of liability, there would still be 16,000 pending cases without an organizational vehicle for an efficient collective resolution.[75]

It would appear possible, even within the constraints of an opt-in procedure, to implement rules that provide protections against future litigation similar to those that can be obtained in an opt-out regime. Jurisdictions could provide that class members who do not opt in are free to bring later individual actions but cannot thereafter participate in other class actions. A rule that allows only one opportunity to participate in a class action would accomplish effective global peace. Although class members who do not opt in can bring later individual actions, few will do so because it is not economically viable to litigate consumer cases on an individual basis.

4. Deterrence

Finally, let's consider the deterrent effect of opt-out and opt-in procedures. Here, the opt-out approach offers advantages, although these are not always realized in actual cases. With an opt-out procedure, the class consists of everyone who has not opted out, which will be the vast majority of class members given consumer inertia. To persuade a court that a settlement is "fair, reasonable, and adequate,"[76] therefore, the plaintiffs' attorney must argue that the benefits of the litigation are sufficient for everyone who remains in the class. With an opt-in procedure, in contrast, the settlement need only provide benefits that are adequate for the (usually much smaller) set of plaintiffs who have joined the litigation. Therefore, as a general matter, opt-out procedures offer better deterrence because they impose on the defendant more of the social cost of the defendant's wrongful behavior.

However, here as elsewhere, the analysis is not quite that simple. Attorneys in U.S. cases have found ways to make class action settlements resemble outcomes under an opt-in rule. When a common fund is created, some settlements contain "reverter" clauses providing

74. Defendants apparently prefer the opt-in rule, notwithstanding its impact on their ability to obtain a comprehensive settlement, because of the substantially lower damages they expect to pay under this procedure, a point we address below.

75. *See supra* note 7.

76. FED. R. CIV. P. 23(e)(2).

that any amounts not claimed revert to the defendant.[77] Reverter settlements are no longer seen in securities class actions,[78] but reverters are occasionally found in other contexts. Much more common these days is the consumer class action settlement where the defendant promises to provide relief in a defined amount to every class member who files a claim. These settlements, as a practical matter, are similar to settlements under opt-in class actions because the defendant ends up having to pay out only to those class members who file claims—usually only a fraction of the class.

It might be possible, under European systems, to combine an opt-in procedure with the assessment of damages to the entire class, thus achieving better deterrence. Courts could order undifferentiated relief for classes and apportion it on a pro rata basis to class members who opt in and claim. This is the way many class action settlements are handled in the United States. The settlement administrator holds the claim forms until the claim period has expired and then distributes the settlement proceeds to the claiming members in proportion to their claims. Alternatively, claims administrators pay out proven claims as they come in and then make a second distribution of unclaimed amounts to class members who have filed claims. If distribution to claiming class members is considered problematic because some would receive more than their actual damages, jurisdictions could consider alternative recipients of the excess damages, such as escheats to the government. Strategies such as these, if permissible under governing law, could go far towards improving the deterrent effect of opt-in class actions.

III. CONCLUSION

At bottom, the gulf between the European and American developments in class actions and other forms of aggregation reflects a deeper divide than doctrines and formal laws alone would reveal. For the civil law countries of continental Europe, the resistance to

77. *See* Geoffrey P. Miller & Lori S. Singer, *Nonpecuniary Class Action Settlements*, 60 LAW & CONTEMP. PROBS. 97, 106 (Autumn 1997) (examining reverter clauses). Reverter clauses offer the benefit that they may be valued, for purposes of calculating percentage attorneys' fees, as if the entire benefit had gone to the class, even though the defendant expects to receive some of the settlement consideration back. *See* Boeing Co. v. Van Gemert, 444 U.S. 472, 481–82 (1980) (ruling that class counsel attorneys' fees may be calculated based on the total funds potentially available for relief rather than the actual payout).

78. This is probably due to the fact that the PSLRA requires that percentage fees be based on the amount of any damages "actually paid to the class." 15 U.S.C. § 78u-4(a)(6) (2000). This provision reverses the presumption in *Boeing Co. v. Van Gemert* that fees can be based on the full amount that would be paid if all class members filed claims. 444 U.S. at 481–82.

collectivist measures of adjudication is in part a continuation of what Hayek has termed a "constructivist rationalism"—a deep-seated belief in the importance of rationalist expertise in top-down administrative decisionmaking.[79] What characterizes the American legal tradition—what Hayek in turn would term "spontaneous order"[80]—is the common law attachment to the bottom-up competitive evolution of legal rules.[81] One need not fully endorse Hayek's further claim about the inherent superiority of the less intrusive forms of common law regulation[82] to recognize that class actions allow non-state actors to assume the collective responsibility that civil law systems have traditionally reserved exclusively for the state.

Thus, when the evolving laws of aggregate procedure in the United States and Europe are held up for comparison, what seems to jump out is a core question: Who will organize, fund, and lead the collective efforts? We focus on these issues to highlight our—admittedly American—reaction to the emerging trends in Europe. Both the strengths and the weaknesses of American collective procedures arise from the willingness to entrust a great deal of social regulation to private initiative and common law forms of adjudication. Once unleashed in the United States, private actors found ways to harness aggregative procedural devices, most notably class actions, to create powerful litigation tools and, by extension, a new source of common law decisionmaking. The evolving European law attempts to realize some of the benefits of collective dispute resolution, but it is conspicuously limited in its conception of how these processes will be realized. From the American vantage point, we look at the European experiments with a concern that law without the institutional framework for its enforcement is necessarily lacking.

At the end of the day, it is all well and good to lay down railroad track and invest in a stock of modern trains. But someone has to drive the train. The United States has a creaky rail network and trains that are the envy of no one. Compared to the rail systems of Europe, it is difficult to believe that a wealthy country cannot connect

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79. The term itself is formulated in 1 FRIEDRICH A. HAYEK, LAW, LEGISLATION AND LIBERTY: RULES AND ORDER 95 (1973). Hayek attributed this view to a Cartesian belief that all advances in human society and knowledge were the product of reasoned design. *Id.* at 10–12.

80. *Id.* at 118–22.

81. *See* RICHARD A. POSNER, LAW, PRAGMATISM, AND DEMOCRACY 275–76 (2003) (analogizing Hayek's "spontaneous order" theory to Darwin's theory of natural selection).

82. *See* Paul G. Mahoney, *The Common Law and Economic Growth: Hayek Might Be Right*, 30 J. LEGAL STUD. 503, 504 (2001) ("[Friedrich Hayek] argues vigorously that the English legal tradition (the common law) is superior to the French (the civil law), not because of substantive differences in legal rules, but because of differing assumptions about the roles of the individual and the State.").

its major cities efficiently. But, in our legal analogue, we do have trained engineers quite willing to drive class action cases forward. This may not be much; it may not be sufficient; it may at times prove problematic; but it may also prove to be necessary.