PROGRAM MATERIALS
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The Conservative Case for Class Actions?

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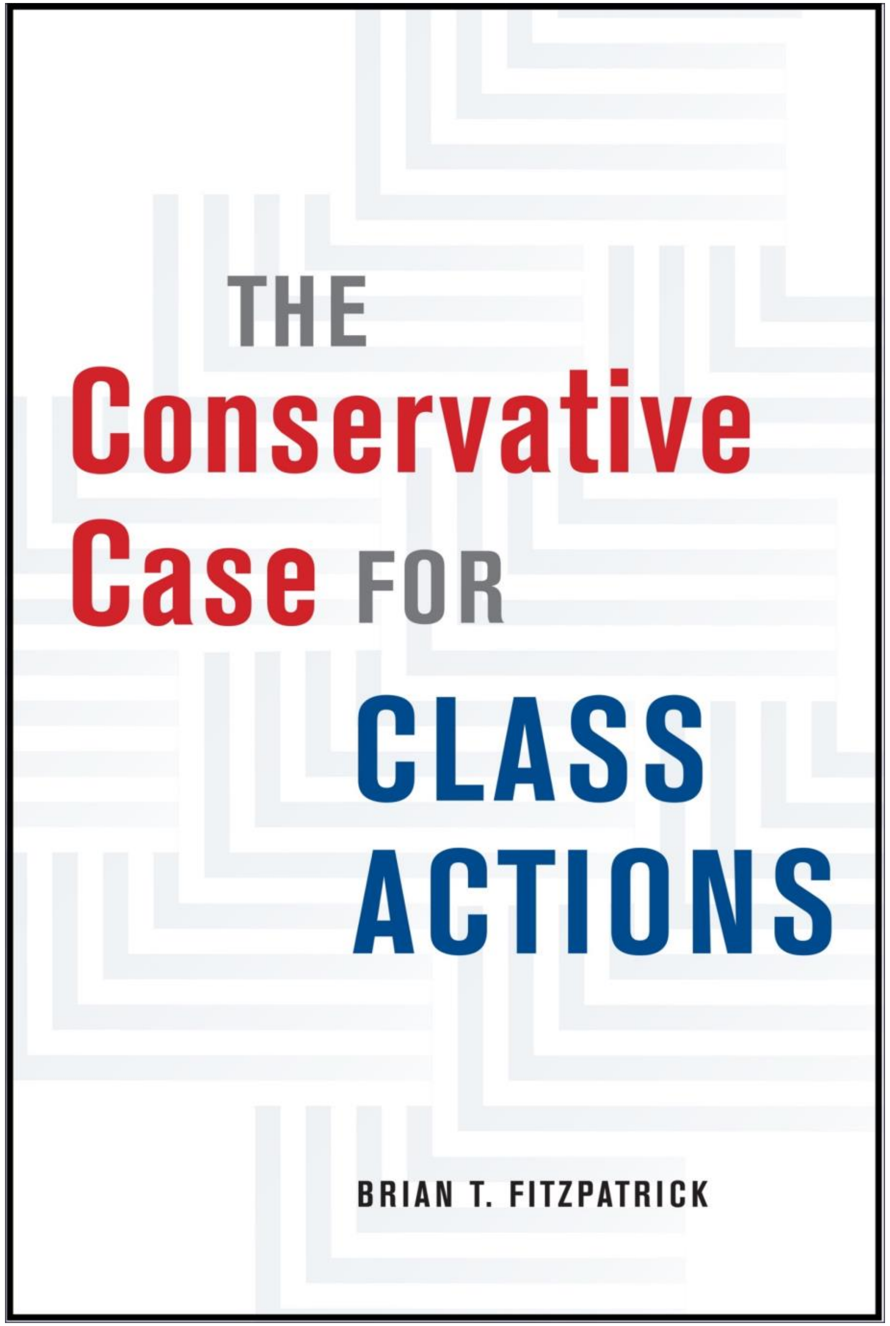

Brian Fitzpatrick
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1.
Milton Friedman

"The free enterprise system is not going to be saved by General Electric, General Motors, or Mobil Oil."

2.
Friedrich Hayek

"An effective competitive system needs an intelligently designed and continuously adjusted legal framework as much as any other."

3.
Design Options

	Ex Ante	Ex Post
Government	1	2
Private	3	4

4.
Why Private is Better than Government

Smaller government

More self help

Better incentives

Better resources

More independent

Less centralized

5.
Richard Epstein

"[T]he class action is here to stay. And so it should, for there is no question that . . . it allows plaintiffs with sound but small substantive claims to gain access to the courthouse that would be denied to them without some method of amalgamation."

6.
Gary Becker & George Stigler

“[T]he view of enforcement and litigation as wasteful in whole or in part is simply mistaken. They are as important as the harm they seek to prevent.”

7.
The U.S. Chamber of Commerce

"[C]lass action claims are often meritless."

"[C]lass action attorneys . . . recover[] astronomical attorneys' fees [and] the class members receive little or no benefit."

"[S]ocial scientists have not been able to empirically measure . . . the deterrent effect of class litigation . . . . [T]he deterrent effect [is] largely [a] theoretical, conclusory pronouncement[]."

8.
A More Perfect Class Action

Limit class actions to “good” substantive laws

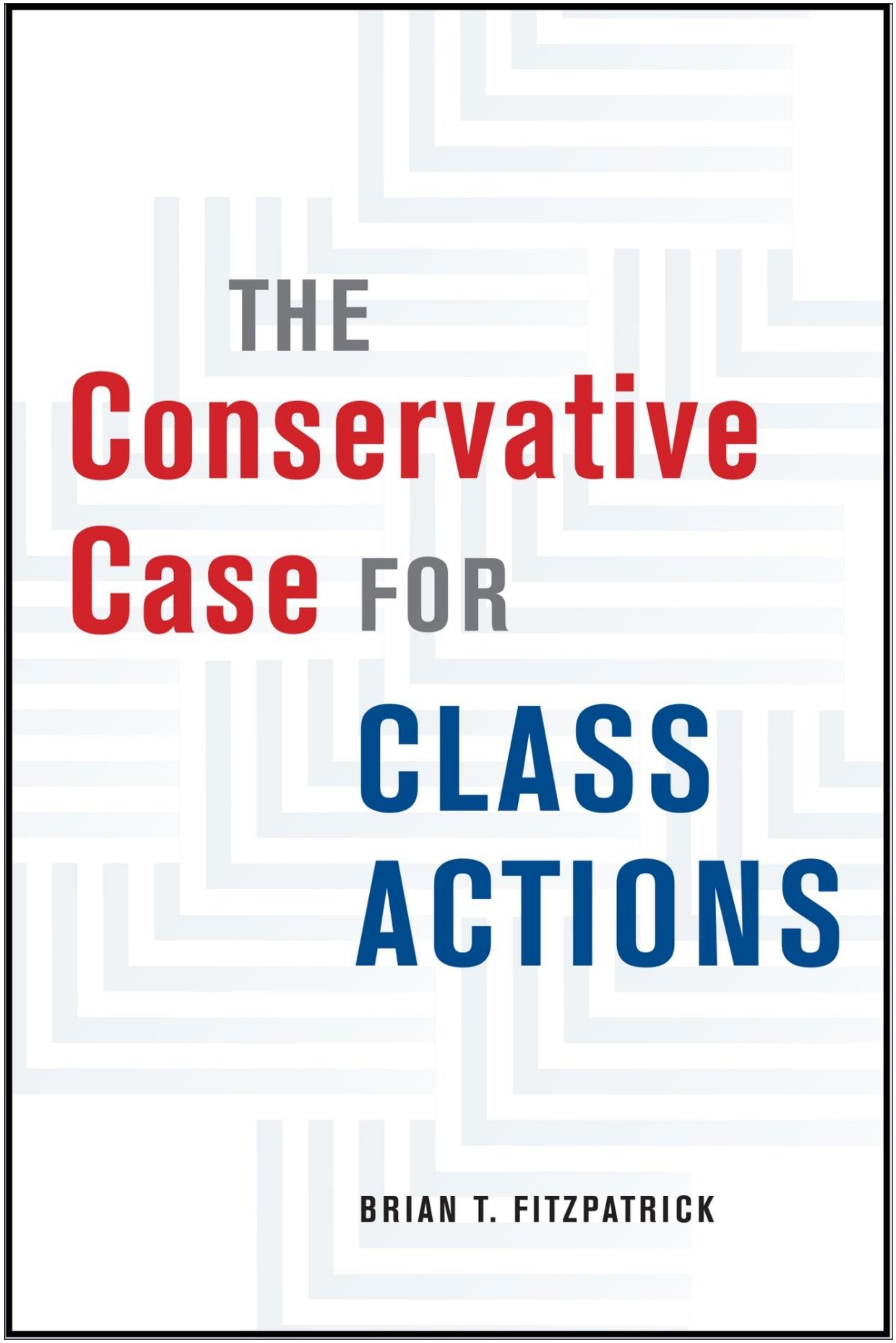
Share more discovery costs

Stay discovery pending motion to dismiss plus interlocutory appeal

Use sampling at trial

Pay class action lawyers a percentage plus lodestar

End class action waivers



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Introduction

This book is about conservative principles. This is a matter I know something about; I have been a conservative my entire life. As an adolescent, I subscribed to *National Review* and read books by Dinesh D'Souza. Ever since my first semester of law school, I have been a member of the Federalist Society. After law school, I worked for two of the most conservative judges—Diarmuid O'Scannlain on the Ninth Circuit and Nino Scalia on the Supreme Court—as well as for one of the most conservative members of the U.S. Senate—John Cornyn of Texas. I have never voted for a Democrat for president in my entire life.

One thing I have learned over the years is that what is good for conservative principles is not always what is good for big corporations. It often is, but not always. Consider what perhaps the most famous conservative academic of them all--the economist Milton Friedman—says on this question:

> Over and over again you have the big businessman who talks very effectively about the great virtues of free enterprise and, at the same time, he is off on a plane to Washington to push for special legislation or some special measures for his own benefit. I don't blame him from the point of view of his business, but . . . I do blame the rest of us for not recognizing that [the free enterprise] system is not going to be saved by [the] National Association of Manufacturers, the Chamber of Commerce—you name them—the big organizations and big business—they are almost always on the wrong side.[i]

In other words, "being pro-free enterprise may sometimes require that we be anti-existing business."

We see examples of the difference between conservative principles and the interests of big business all the time. Consider states' rights. Conservatives like to decentralize power by divesting it to the states; yet big corporations often lobby the federal government to start regulating things in order to override state laws the corporations don't like. Or consider price controls. Conservatives *hate* government-imposed price controls on goods and services because we believe the market knows better than any government bureaucrat what the right prices are; yet, in recent years, big corporations lobbied Congress for a price control on what lawyers could charge their clients in many personal injury cases, asking to cap lawyers' fees at 20 percent of recoveries.

I believe we should add one more item to the list of things that may be good for conservative principles even though they may be bad for big corporations: class action lawsuits.

Although class action lawsuits can be filed against anyone—including the government—my focus in this book is on class action lawsuits that are filed against corporations because these are the class actions that have become controversial in recent years. It should come as no surprise that corporations don't like class action lawsuits. They cost them billions of dollars every year. For this reason, big corporations have been trying to get rid of class action lawsuits ever since we put them on the books in 1966.

I like corporations. I happily represented corporations every day during my years as a practicing lawyer, and I still thank them frequently for all of the prosperity they bring our country. But they are wrong about class actions. As I explain in my book, class action lawsuits are not only the most effective way to hold corporations accountable, they are also the most *conservative* way to hold them accountable. In fact, there are only two alternatives, and neither of them should be the least bit appealing to conservatives.

The first alternative is to rely entirely on market feedback loops. If a company does something bad, won't it lose customers? If so, then shouldn't the fear of losing customers be enough to keep companies in line? Conservatives do like market feedback loops, but almost no conservatives think market feedback loops are sufficient to keep companies in line. Although conservatives are often caricatured as against all regulation of the market, this caricature is not true. Almost all conservatives know that markets need at least *some* rules. At the very least, we support rules requiring companies to honor their contracts, rules preventing companies from committing fraud, and rules prohibiting companies from forming cartels to fix prices. No one really thinks companies ought to be able to do whatever they can get away with.

But someone has to enforce these rules. Who will do it if there are no class action lawsuits? Relying on each person a company steals from to enforce the rules is unrealistic: people sometimes don't know about the theft, and, even when they do, the theft might not be worth enough to hire a lawyer. Class actions overcome these problems by letting one person sue for everyone else; this transforms an unprofitable lawsuit for a small amount of money into a profitable lawsuit for a lot of money.

This brings me to the second alternative to the class action: the government. The government could file lawsuits against companies to disgorge all their ill-gotten gains. But when is the last time conservatives thought the government was the best solution to a problem? Conservatives believe that the private sector is better at doing most everything than the government is. We favor private schools, private highways and railroads, private prisons, private parks, private retirement accounts, private venture capitalists, and private insurers—just to name a few—rather than public ones. But that's exactly why we should like class action lawsuits: they are *privatized* enforcement of the law. That's why we often refer to class action lawyers as *private attorneys general*. As with just about everything else, we should favor the *private* attorney general over the public one.

The funny thing is, for most of American history, what I have said thus far was not particularly controversial. It was liberals who thought the government should police the marketplace and conservatives and libertarians who thought it should be private lawyers representing private citizens. Hence, in 1940, perhaps the most liberal president in American history, Franklin Delano Roosevelt, vetoed a bill because he thought that it tilted enforcement of the law too far in favor of private lawyers over government agencies. As late as 1978, perhaps the second most liberal president in American history, Jimmy Carter, proposed abolishing most private class action lawsuits and replacing them with government lawsuits instead. During all this time, it was conservative Republicans in Congress and elsewhere who argued that, if laws were to be created, they should be enforced by the private bar not the government.

Something changed in recent years. Today, most conservatives seem to want to get rid of class action lawsuits just like Jimmy Carter did in 1978. When a major class action case called *AT&T Mobility v. Concepcion* came before the U.S. Supreme Court a few years ago, many conservatives wrote to the Court and urged it allow companies to insulate themselves from class action lawsuits entirely by adding fine print to their contracts. The five conservatives on the Supreme Court readily agreed and have now put the class action lawsuit on the road to its demise. The same anti-class action sentiments reign supreme among Republicans in Congress, where proposals to abolish or seriously curtail class action lawsuits against corporations are frequently introduced and sometimes enacted.

Why the change of heart? Why are today's conservatives taking advice from Jimmy Carter? Part of the answer is the cozy relationship between today's Republican Party and big corporations. But some of the opposition is more principled. Some conservatives complain that the underlying rules we have adopted in the market go too far, and, if the underlying rules go too far, then those who are trying to enforce them must be going too far as well. I completely understand this. We regulate companies way too much—well beyond the simple rules I mentioned above against breach of contract, fraud and price fixing. But the solution to this problem is not to kill *all* class action lawsuits; it is to get rid of the rules we don't like—or, if that is not possible, to kill *only* the class actions that seek to enforce rules that we don't like. We should not throw the class action out with the bathwater, but that's precisely what the Supreme Court's *Concepcion* decision threatens to do.

Other conservatives oppose class actions because they don't like that the lawyers who file these cases are motivated by making money. I find this remarkable. Conservatives normally love the profit motive! Indeed, it is one of the reasons why we want to privatize everything in the first place. Profit-motivated private citizens do a better job than salaried, tenured government bureaucrats do, and relying on private citizens to do things reduces the size of government and the taxes we have to pay to support it. So why have we turned our backs on the profit motive here? Some conservatives say that the profit motive has led the lawyers to abuse the system. Some of these claims are based on myths about class actions that I debunk in the book. But it is certainly true that an unbridled profit motive can lead to destructive consequences. But this is true of any profit motive, including the profit motives of corporations. We aren't afraid of corporate profit motives, and we shouldn't be afraid of lawyers' profit motives either. The challenge is to put rules into place to harness the good of the profit motive without the bad. We do this for corporations by regulating them. We can do the same for class action lawyers.

What would the rules for class action lawyers look like? Many of them are already in place: judges already have the power to dismiss meritless class action lawsuits as soon as they are filed, and they already must scrutinize the lawsuits before they go to trial, approve any settlements, and award the fees the lawyers earn. Most judges exercise these powers wisely, but I offer few suggestions in my book to make our system even better. But I agree with our corporate friends that we may need some new rules altogether. Right now, you can bring a class action lawsuit for almost any violation of the law. But, as I noted, we don't like a lot of the laws that we make companies comply with. Perhaps we should reserve the class action only for the good laws like breach of contract, fraud, and horizontal price fixing? Right now, class actions are too expensive and risky for companies to defend—one jury can resolve hundreds, thousands or even millions of claims all at once—and class action lawyers know it; this leads them to demand settlements from companies that may be more than the companies should have to pay. Perhaps we should make it even easier to dismiss meritless cases, break up class action trials into smaller pieces to reduce the risks, and require class action lawyers to share more of litigation expenses than they do now?

I focused this book on conservatives because, if the class action is to survive, it is conservatives who need to be persuaded. We are the ones who are killing it. But if I can be persuaded, I think others can be as well. We can mend the class action; we don't have to end it.

Do Class Actions Deter Wrongdoing?

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The Class Action Effect (Catherine Piché, ed., Éditions Yvon Blais, Montreal, 2018)

Do Class Actions Deter Wrongdoing?

Brian T. Fitzpatrick*

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INTRODUCTION

The class action is said to serve three principal purposes: litigation efficiency, compensation of victims, and deterrence of wrongdoing.[1] When the claims at issue in a class action are small, as they usually are in the United States, it is unlikely that any litigation efficiency is gained because there would be no individual litigation at all in the absence of the class action. This leaves us with compensation and deterrence. But the class action is not known for its success at delivering compensation to class members in small-stake cases; sometimes it does it well—and it may get better as technology improves—but, in the run-of-the-mill case, only a small percentage of victims are made whole.[2] None of this has bothered me or many other scholars, because we have always pointed to the deterrence virtue of the class action, arguing that it alone is enough to justify the class device.[3]

In recent years, however, critics have begun arguing that class actions may not even offer any deterrence. This is a change from the usual complaint critics make about class actions and deterrence: that they deter too much.[4] But there they are nonetheless: some argue that the entire theory of deterrence is inapplicable to class actions and others argue that, whatever the theory, there is no empirical proof that class actions do what the theory says.[5]

In this article, I take up these critiques: Is there any reason to doubt the theory of deterrence as applied to class actions? Is it

1. Jay TIDMARSH, *Class Actions: Five Principles to Promote Fairness and Efficiency*, LexisNexis, 2013, §1.03.
2. Brian T. FITZPATRICK and Robert C. GILBERT, "An Empirical Look at Compensation in Consumer Class Actions", (2015) 7 *New York University Review of Law & Business* 771-772 and 778.
3. Brian T. FITZPATRICK, "Do Class Action Lawyers Make Too Little?", (2010) 158 *University of Pennsylvania Law Review* 2067.
4. John C. COFFEE, Jr., *Entrepreneurial Litigation*, Cambridge, MA, Harvard, 2015, p. 134.
5. See text accompanying notes 26, 32, 45-46, *infra*.

true that there is no empirical evidence in favor of the theory? As I will show, the theory of deterrence remains just as strong today as it was when it was introduced 50 years ago by the "classical" law and economics movement. Moreover, although there is not a great deal of empirical evidence to support the theory for class actions, there is some, it is uncontroverted, and it is consistent with reams and reams of empirical evidence in favor of deterrence for individual lawsuits. In short, the conventional view that the class action can be justified by the deterrence rationale alone remains sound.

1. SPECIFIC VERSUS GENERAL DETERRENCE

Let me begin by making an important distinction that is sometimes overlooked in the discussion about class actions and deterrence. There are two types of deterrence, and it is hard to deny that class actions *do* accomplish one of them.

One type of deterrence is known as "specific deterrence." Specific deterrence refers to how an *actual* wrongdoer responds to an *actual* lawsuit against it: does that wrongdoer stop the misbehavior after it gets caught?[6] General deterrence, by contrast, refers to how *potential* wrongdoers respond to a *potential* lawsuit: do potential wrongdoers decide not to commit misconduct to begin with because they are afraid of lawsuits against them?[7]

There is little doubt that class action lawsuits generate specific deterrence. How do we know this? We know this because when class action lawsuits are resolved they often include a court order obligating the defendant to change its behavior. Almost all class actions that are not dismissed are settled, and, when I examined every single one of them in U.S. federal court over a two-year period, I found that, almost one quarter of the time, the settlement included a provision requiring the defendant to change its behavior in some way.[8]

6. See, for example, Sean FARHANG: "specific deterrence refers to the effects of enforcement against a particular violator on *that* violator's future conduct …", *The Litigation State: Public Regulation and Private Lawsuits in the U.S.*, Princeton, NJ: Princeton University Press, 2010, p. 9.
7. See, for example, FARHANG: "general deterrence refers to effects of visible enforcement efforts in the legal environment on other would-be violators who have yet to actually be the targets of enforcement and hope never to be", *ibid*.
8. See Brian T. FITZPATRICK, "An Empirical Study of Class Action Settlements and Their Fee Awards", (December 2010) 7 4 *Journal of Empirical Legal Studies* 811-846.

In some types of class action lawsuits, I found behavior-modification provisions as often as 75% of the time.[9] But even when there was no behavior modification provision, this does not mean the class action did not cause specific deterrence: sometimes defendants drop offending practices on their own after they get sued.[10]

Some critics complain that the behavior-modification provisions in class action settlements are cosmetic and do not impose real restrictions on corporations.[11] This is a difficult complaint to evaluate without digging into the merits of each and every one of the hundreds of class action settlements that are approved every year. Although I have examined these settlements for my research, I was in no position to assess the merits of each case. But I have served as an expert in dozens of class action cases where I did dig into the merits, with many of these cases having ended in settlements that included behavior-modification provisions, and the provisions in my cases were not toothless.[12] I also know that class action critics have not identified very many toothless provisions when they have had the chance to do so. Of the thousands upon thousands of class action settlements over the past few years, I could find only a small

9. See *ibid*.
10. See, *e.g.*, my declaration found in Exhibit 2 of the Motion for Attorneys' Fees in *Fernandez* v. *Merrill Lynch, Pierce, Fenner & Smith*, No. 15-22782 (S.D. Fla., Nov. 28, 2017), where I noted that the settlement did not include "an injunction obligating the defendant to secure mutual fund fee waivers in the future for class members' accounts … only because the defendant already transitioned those accounts to a platform that ensures they will not be charged the improper mutual fund fees in the future."
11. See, for example, Erin L. Sheley and Theodore H. Frank's complaint that many injunctions "amount to no more than a rearranging of the deck chairs to create the illusion of value to justify attorney's fees." "Prospective Injunctive Relief and Class Settlements", (April 2012) 39:3 *Harvard Journal of Law and Public Policy* 779-780.
12. For example, in several settlements in class action lawsuits against banks for reordering their customers' debit card transactions from chronological order to an order that maximized the number of overdraft fees the bank could charge them, the settlements included provisions forbidding the banks from reordering their customers' transactions in the future. See *Harris* v. *Associated Bank, N.A.*, Docket No. 10-cv-22948-JLK (S.D. Fla., Aug., 2, 2013); *Wolfgeher* v. *Commerce Bank, N.A.*, Docket No. 10-cv-22017-JLK (S.D. Fla., Aug. 2, 2013); *McKinley* v. *Great Western Bank*, Docket No. 10-cv-22770-JLK (S.D. Fla., Aug. 2, 2013); *Eno* v. *M & I Marshall & Illsley Bank*, Docket No. 10-cv-22730-JLK (S.D. Fla., Aug. 2, 2013); *Blahut* v. *Harris Bank, N.A.*, Docket No. 10-cv-21821-JLK (S.D. Fla., Aug. 5, 2013); *Casayuran et al.* v. *PNC Bank, N.A.*, Docket No. 10-cv-20496-JLK (S.D. Fla., Aug. 5, 2013).

handful alleged to include cosmetic behavior modifications[13]—with one exceptional area of litigation.[14] In my view, critics have thus far not given us much reason to question the efficacy of specific deterrence in class actions.

But I will not discuss specific deterrence further here. In my mind, the more interesting debate in class action circles is about general deterrence.

2. THE THEORY OF GENERAL DETERRENCE

In the very first semester of the very first year in every law school in America, students have been taught for the last 50 years that the threat of a lawsuit deters misbehavior,[15] largely due to theories propounded by the famous "Chicago School" of law and

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13. The only list of any sort I could find was an article by Erin Sheley and Ted Frank identifying less than 10 cases outside the merger litigation I discuss below. "Prospective Injunctive Relief and Class Settlements", *supra*, note 11, 779-784.
14. The exception is class action lawsuits brought to challenge corporate mergers. In recent years, the great majority of mergers have faced one or more of these lawsuits and the lawsuits nearly always settle for an order mandating that the companies give more information about the merger to their shareholders. See Sean GRIFFITH and Anthony RICKEY, "Who Collects the Deal Tax, Where, and What Delaware Can Do About It", in *Handbook on Shareholder Litigation*, Jessica ERICKSON *et al.* (eds.), Edward Elgar, forthcoming. Scholars have shown these ordered disclosures to be meaningless to shareholders. See Jill E. FISCH, Sean J. GRIFFITH and Steven DAVIDOFF SOLOMON, "Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform", (2015) 93 *Texas Law Review* 557-558. I agree these settlements should be rejected, and that is precisely what courts have started doing now that it has become known how meaningless these orders are to the class. See Sean J. GRIFFITH, "Private Ordering Post-*Trulia*: Why No Pay Provisions Can Fix the Deal Tax and Forum Selection Provisions Can't", in *The Corporate Contract in Changing Times*, Steven DAVIDOFF SOLOMON and Randall THOMAS (eds.), University of Chicago Press, forthcoming. Although these settlements have indeed been numerous in recent years, they are a very special—and very narrow—slice of our class action system. They are not a basis to conclude that most or even many behavior-modification orders are cosmetic.
15. Scholars have identified this fact as a key part of the justification for private enforcement. As John C. Coffee writes: "The conventional theory of the private attorney general stresses that the role of private litigation is not simply to secure compensation for victims, but is at least equally to generate deterrence, principally by multiplying the total resources committed to the detection and prosecution of the prohibiting behavior." "Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working", (1983) 42 *Maryland Law Review* 218.

economics.[16] By now, most of us in the academy accept the theory of general deterrence without question.

It is easy to see why the theory is so powerful. All we have to do is assume people are rational. A rational person does not want to get sued. Lawsuits cost money. You have to pay lawyers, and, if you lose, you have to pay the plaintiff. This means that lawsuits are a great way to stop people from misbehaving when we don't want them to: all you have to do is set the damages awarded in a lawsuit equal to an amount related to the harm the misbehavior inflicts on the injured party.[17] If the misbehavior benefits the corporation less than the harm it inflicts on others, then the corporation will rationally choose not to engage in the misconduct. Indeed, the only time the corporation will rationally choose to engage in the misconduct is when the benefits outweigh the harm, but that's ok: we want people to do things that generate more benefits than costs if we can make the injured party whole in the process. This is what we call "internalization of costs."[18] The rational-actor model of cost internalization is at the core of "classical" law and economics.[19]

It is true that lawsuits are not the only way we can deter misbehavior. Relying on word of mouth in the marketplace can also be effective. If a company mistreats its customers, employees, or shareholders, then the customers, employees, and shareholders can tell

16. A description of the Chicago School's economic theory of deterrence can be found in William M. LANDES and Richard A. POSNER's landmark article "The Private Enforcement of Law", (January 1975) 4:1 *Journal of Legal Studies* 1-46. For a discussion of how the theory of general deterrence became a central part of modern law, one need only turn to a commonly assigned first-year torts textbook. See John C.P. GOLDBERG, Anthony J. SEBOK, and Benjamin C. ZIPURSKY, *Tort Law: Responsibilities and Redress*, New York, Wolters Kluwer, 2016, p. 211.
17. Gary S. BECKER first set forth a criminal law version of the theory in "Crime and Punishment: An Economic Approach", (March–April 1968) 76:2 *Journal of Political Economy* 169-217. But the theory has been applied many times over to civil liability, such as by LANDES in "Optimal Sanctions for Antitrust Violations Antitrust Damage Reform", (1995) 50 *University of Chicago Law Review* 657. There is debate over how exactly to set the relationship between damages and harm, see Amanda ROSE, "Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5", 108 (2008) *Columbia Law Review* 1328-1330.
18. See, *e.g.*, POSNER, "A Theory of Negligence", (1972) 1:1 *Journal of Legal Studies* 29-96.
19. See, *e.g.*, Claire FINKELSTEIN, "Legal Theory and the Rational Actor", in *The Oxford Handbook of Rationality*, Alfred R. MELE *et al*. (ed.), Oxford Oxford University Press, 2004, p. 399.

others to go elsewhere. But it should be noted that lawsuits *enhance* market feedback loops: lawsuits publicize wrongdoing to consumers, employees, and shareholders in a way that word of mouth does not on its own.[20]

Many scholars today do not fully accept classical law and economics because they think the underlying model of human behavior is inaccurate: people, it turns out, are not very rational.[21] There are

20. As Russell M. Gold explains, "litigation can and frequently does inflict nonlegal harms on defendants such as harm to their reputation" because "legal process draws attention to and is seen to substantiate allegations." "Compensation's Role in Deterrence", (1997) 91 *Notre Dame Law Review* 2007-2023. Indeed, a number of empirical studies have found that this risk of reputational harm from litigation is a more effective deterrent than the monetary penalties companies face from losing lawsuits. See Brent Fisse and John Braithwaite's case studies of major corporate scandals in the 1960s and 1970s, *The Impact of Publicity on Corporate Offenders*, Albany, NY, State University of New York Press, 1983, p. 243. See also Jonathan M. Karpoff and John R. Lott, Jr.'s research indicating that from 1978-1987, 93.5% of companies' stock price declines after initial press reports of alleged corporate fraud were attributable to reputational loss and only 6.5% was attributable to formal legal penalties. "The Reputational Penalty Firms Bear from Committing Criminal Fraud", (October 1993) 36:2 *Journal of Law and Economics* 784. Similarly, John D. Graham writes that "the indirect effect of liability on consumer demand—operating through adverse publicity … is often the most significant contribution of liability to safety." "Product Liability and Motor Vehicle Safety", in *The Liability Maze: The Impact of Liability Law on Safety and Innovation*, Peter W. HUBER and Robert E. LITAN (ed.), Washington D.C., Brookings Institution, 2010, p. 181-182. Joni Hersch's research has found that the average drop in the equity value of a firm the day an employment discrimination class action is announced is triple the direct costs of settling the case. "Equal Employment Opportunity Law and Firm Profitability", (1991) 26:1 *Journal of Human Resources* 152. See also Jonathan M. Karpoff, D. Scott Lee and Gerald S. Martin's research indicating securities enforcement proceedings generate reputational losses seven and a half times larger than the legal penalties produced by the same proceedings. "The Cost to Firms of Cooking the Books", (September 2008) 43 *Journal of Financial and Quantitative Analysis* 581-612. See also KOKU, "An analysis and the effects of class-action lawsuits", (2006) 59 *Journal of Business Research* 508 (finding that stock-price "reactions to the announcement of class-action lawsuits are larger in magnitude" than non-class-action lawsuits).
21. As Nobel Prize winning economists Daniel Kahneman and Amos Tversky write: "In making predictions and judgments under uncertainty, people do not appear to follow the calculus of chance or the statistical theory of prediction. Instead, they rely on a limited number of heuristics which sometimes yield reasonable judgments and sometimes lead to severe and systematic errors." "On the Psychology of Prediction", (1972) 8:4 *Psychological Review* 237. See also KAHNEMAN and TVERSKY, "Prospect Theory: An Analysis of Decision Under Risk", (1979) 47:2 *Econometrica*.

now countless studies[22] and even popular books[23] showing how all of us make the same types of mistakes over and over again when we try to process information; we do not simply add up the costs and compare them to the benefits before we act. These so-called "behavioral" economists seek to update the classical rational-actor model with findings from these studies.[24] The behavioral findings are admittedly powerful, but none of them suggest that the usual defendants in class actions—corporations—are predictably irrational in the same way the rest of us are.[25]

So why do critics think that the theory of general-deterrence-through-lawsuits is wrong when the lawsuits are class action lawsuits? There are two reasons.

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22. For a sense of the scope of this field, in July 2017, Google Scholar counted approximately forty-five thousand academic citations to Kahneman and Tversky's 1979 article on prospect theory alone.
23. See Dan ARIELY, *Predictably Irrational: The Hidden Forces that Shape our Decisions*, HarperCollins, 2008; Daniel KAHNEMAN, *Thinking Fast and Slow*, Farrar, Straus and Giroux, 2011; Richard H. THALER and Cass R. SUNSTEIN, *Nudge: Improving Decisions about Health, Wealth, and Happiness*, Yale University Press, 2008.
24. See Justin FOX, "From 'Economic Man' to Behavioral Economics", (May 2015) *Harvard Business Review* 79-85.
25. Stefano DellaVigna explains why this is: "Unlike individual consumers, firms can specialize, hire consultants, and obtain feedback from large data sets and capital markets. Firms are also subject to competition. Compared to consumers, therefore, firms are less likely to be affected by biases … and we expect them to be close to profit maximization." "Psychology and Economics: Evidence from the Field", (June 2009) 47:2 *Journal of Economic Literature* 361. It is true that there has been some research that indicates that firms are sometimes not perfectly rational actors. See Ulrike MALMENDIER and Geoffrey TATE, "CEO Overconfidence and Corporate Investment", (2005) 60:6 *Journal of Finance*. However, there are three good reasons to think that firms behave more rationally than individuals. First, firm decision making tends to be done by groups, and group decision making tends to be more rational than individual decision making. See Tamar KUGLER *et al.*, "Are Groups more Rational than Individuals? A Review of Interactive Decision Making in Groups", (2012) 3:4 *Wiley Interdisciplinary Review: Cognitive Science* 425. Second, much of the literature identifying irrational corporate behavior does so by finding circumstances in which certain firms deviate from the rational behavior of other firms—suggesting the default is rational behavior, punctuated by occasional failures. See Malmendier and Tate, above. Third, and perhaps most importantly, research indicates firms are consistent about pursuing their rational self-interest, unlike individuals who are often more concerned with non-rational considerations. Phanish PURANAM *et al.*, "Modelling Bounded Rationality in Organizations: Progress and Prospects", (2015) 9 *Academy of Management Annals* 392.

The first reason is "principal-agent costs": the corporations (and, ultimately, the shareholders) pay the bills, but the corporate executives make the decisions, and sometimes the twain shall not meet.[26] But this is a problem only if corporations do not try very hard to align the interests of corporate officers and the corporation. Much of the concern with principal-agent costs comes from the fact that corporate officers may have left the corporation by the time the bills for their decisions come due.[27] But companies can delay or rescind their compensation in such circumstances to equalize the corporate and officer time horizons, for example with vesting stock options.[28] Indeed, most companies already do this.[29] In theory, almost any agency problem can be solved with a well-designed contract.[30]

Indeed, one sign that principal-agent costs are weak reasons to doubt the theory of deterrence for class actions is what the implications are *beyond* class actions. The exact same principal-agent problems that critics say make corporate executives unresponsive to class action lawsuits would make them unresponsive to every

26. This is an especially popular critique in the securities fraud literature. As Coffee explains, "the efficacy of deterrence … rests on the validity of enterprise liability: that is, on the claim that by imposing large penalties on the corporation, society induces increased monitoring of the corporate officials…" "Reforming the Security Class Action", (November 2006) 106 *Columbia Law Review* 1553. Coffee argues, however, that "securities litigation is distinctive [because corporate managers have] stock options. [As such,] enterprise liability may work less well than a strategy that focuses directly on the managers themselves." "Reforming the Security Class Action", 1562-1563.
27. See, for example, Daniel A. Crane's analysis: "[T]he average CEO holds her job for about six years. Mid-level executives, such as divisional managers, typically hold their jobs for an even shorter period, perhaps less than four years. Thus, most of the executives responsible for an antitrust violation will no longer be with the firm by the time a damages award is entered against the company." "Optimizing Private Antitrust Enforcement", (April 2010) *Vanderbilt Law Review* 677, 693.
28. Coffee's analysis is helpful here as well. "[E]conomic theory suggests that vicarious liability is efficient so long as the principal and agent can enter into contracts that reduce the probability of the wrong that is to be deterred. Even given the 'final period' problem, there are conceivable means by which the corporation could write such contracts with its managers, for example, by restricting stock options and other incentive compensation." *Supra*, note 26*,* 1565.
29. As many as 90% of major publicly traded American companies have compensation recoupment policies—often termed "clawback" policies—that permit them to recover bonuses and other performance incentives under certain circumstances. PriceWaterhouseCoopers, "Executive Compensation: Clawbacks 2014 Proxy Disclosure Study", January 2015.
30. See Posner's conclusion that "[a] corporation has effective methods of preventing its employees from committing acts that impose huge liabilities on it." *Antitrust Law*, 2nd ed., Chicago, University of Chicago Press, 2011, p. 271.

other type of lawsuit as well; are critics saying the *entire* theory of general deterrence is wrong? Indeed, not only does this criticism suggest that the theory of deterrence is wrong, it also suggests that the theory of market feedback loops is wrong as well. If we cannot make corporate executives respond to the threat of lawsuits, then why would we think we can make them respond to the threat of consumer, employee, or shareholder boycotts?[31] That is, if class action lawsuits can't deter corporate misconduct because of agency costs, then nothing else that costs the corporation money can either. Thus, if we contend that class action lawsuits are failures, then we have to admit that other lawsuits and the market feedback loops are, too. But no one wants to admit all that.

This brings me to the second reason some critics say class actions don't generate deterrence: corporations cannot avoid the misconduct that leads to class actions because corporations cannot predict which of their activities will lead to class actions.[32] Class actions, they say, target behavior at random; no corporate executive can guess why he will be sued. But, if you can't predict beforehand why you will be sued, then you can't change your behavior to avoid the lawsuit.

There is no doubt that there is uncertainty in our system of justice. Some of this uncertainty is a good thing: we don't want rigid rules in place that box companies in and prevent them from innovating; we'd rather let companies do what they want to do and make

31. Robert H. Land and Joshua P. Davis highlight this inconsistency: "[T]here is an odd—and usually unexplained—inconsistency when proponents of the free market claim that corporations should not be subject to civil liability … : if the free market works in the sense that corporations respond in an efficient manner to market incentives, including by encouraging corporate representatives to act for the benefit of the corporation, why shouldn't the same be true of legal sanctions?" "Comparative Deterrence from Private Enforcement and Criminal Enforcement of the U.S. Antitrust Laws", (2011) 2 *Brigham Young University Law Review* 316.

32. For example, Walter K. Olson complains that litigation has become "essentially a random matter", *The Litigation Explosion: What Happened When America Unleashed the Lawsuit*, New York, Talley, 1992, p. 176–77. Similarly, the U.S. Chamber of Commerce has claimed: "[t]he class action … does not impose burdens only on businesses that engage in wrongful conduct. Instead, the burdens of class actions are chiefly a function of who plaintiffs' lawyers choose to sue…" Letter to Consumer Financial Protection Bureau 53 (December 11, 2013), available online: <http://blogs.reuters.com/alison-frankel/files/2013/12/mayerbrown-chamberletter.pdf>. See also E. Donald Elliott's argument that tort law may not be predictable enough to shape how activities are undertaken; only how often they are undertaken. "Why Punitive Damages Don't Deter Corporate Misconduct Effectively", (1989) 40 *Alabama Law Review* 1058.

them pay the costs later if they harm people. Uncertainty means flexibility.

But uncertainty also means that it is sometimes hard to predict what will happen when a company does something new. But hard to predict does not mean impossible. If there is a 50-50 chance a company might lose a lawsuit, then the corporate executives do not just throw up their hands and say "we don't know what will happen so let's not worry about it." They do what any other rational person would do: they discount the amount of money they would pay out if they lose the lawsuit by the 50% chance they might *not* lose the lawsuit.

But this assumes the company knows it might be sued to begin with. What if it is impossible for the company to know which of its business decisions might get it into trouble? Is it supposed to assume every decision might lead to a lawsuit? How does the company figure out what the damages would be in the lawsuit if it can't even figure out what it might be sued for to begin with?

These are all hard questions, but corporations long ago found a solution to them: they hire lawyers. Yes, they hire dozens or even hundreds of them, pay them big salaries, and ask them to do something called "risk assessment." I am most familiar with risk assessment departments in the automotive industry because one of my colleagues, Kip Viscusi, has chronicled them in great detail,[33] but every other industry does the same sort of thing in one way or another with their in-house legal departments.[34] And it is not only in-house lawyers that do this: companies rely on outside counsel to do it as well. For example, my old law firm sent around this apropos missive not so long ago: "Mitigating Consumer Fraud Class Action Litigation Risk: Top Ten Methods for 2015."[35]

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33. Viscusi comprehensively outlines extensive and pervasive safety design risk analyses done at Ford, Chrysler, and GM in "Pricing Lives for Corporate Risk Decisions", (2015) 68:4 *Vanderbilt Law Review* 1117. See also Graham's claim that "[a]ccording to one large vehicle manufacturer, in 1960 the typical in-house liability spent 5 percent of his time working with design engineers. Today such an attorney spends 40 to 50 percent…" *The Liability Maze: The Impact of Liability Law on Safety and Innovation*, *supra*, note 20, p. 126.
34. As Richard Marcus notes, "articles about the importance corporations place on compliance are rife in the professional literature." "Revolution v. Evolution in Class Action Reform", (preprint, submitted April 2017) *North Carolina Law Review*.
35. See Sidley Austin LLP, email to clients, "Mitigating Consumer Fraud Class Action Litigation Risk: Top Ten Methods for 2015" (January 5, 2015).

Of course, all these lawyers are expensive, and it may be that deterrence through litigation comes with greater transaction costs than deterrence through other means. Moreover, I will admit that sometimes even all these lawyers are completely hopeless at seeing what the future might hold. In some physical injury cases where the harm caused by a company's products does not manifest itself for decades after the company sold the product, I admit that it may be impossible for a company to anticipate that it might be sued.[36] Who knows what law and even science will look like 20 years from now? On the other hand, there are almost no class action lawsuits of this sort anymore; physical injury cases must be brought individually today.[37] Thus, to the extent the 20-years-later problem is a problem, it is not a problem with our class action system.

But you do not have to take my word that corporations can anticipate class action lawsuits. A legal scholar at Suffolk Law School, Linda Simard asked the corporate executives directly.[38] She sent a questionnaire to the general counsel at every company in the Fortune 500,[39] asking them about the class action lawsuits they had faced, and whether they had any ability to predict the lawsuits at the time their corporations made the business decisions giving rise to the class actions.[40] They responded that their ability to predict the class actions they had faced varied based on what kind of lawsuits they were. For some class actions, over 90% of the time they said they had "moderate" or "high" ability to predict that they would be sued.[41] But even for the wiliest class actions of all—those resting on a completely "novel" legal theory—still 25% of the corporate lawyers said

36. Viscusi makes precisely this argument, positing that, in some cases, constant changes in the law and the lag between when a product is manufactured and when a company may face liability mean that "the tort liability system cannot create effective risk reduction incentives for producers." *Reforming Products Liability*, Cambridge, MA, Harvard University Press, 1991, p. 158.
37. See, for example, Robert Klonoff's findings: "A few courts have been willing to certify personal injury class actions for settlement purposes. Examples include the National Football League concussion litigation and the *Deepwater Horizon* case. For the most part, however, personal injury mass torts continue to be adjudicated outside of the class action arena." "Class Actions in the Year 2026: A Prognosis", (2011) 6 *Emory Law Journal* 1600.
38. See Linda Sandstrom SIMARD, "A View From Within the Fortune 500: an Empirical Study of Negative Value Class Actions and Deterrence", (2014) 47:3 *Indiana Law Review* 739.
39. See *ibid*., 750.
40. See *ibid*., 757-761.
41. See *ibid*., 760.

they had a "moderate" or "high" ability to predict they were coming.[42] Our system is hardly random if even the *new* legal theories can be anticipated 25% of the time. Professor Simard is not the only person corporate lawyers have told such things to.[43]

Of course, this survey also shows that even though some corporate lawyers knew they might be sued in a class action lawsuit, their companies did not always decide to refrain from the behavior; they sometimes went ahead and harmed people anyway. You might be asking yourself: how are class actions deterring anything if corporations are committing misconduct even when they know they might be sued? One answer is that even if the deterrence is imperfect (*e.g.*, maybe damages are set too low by the substantive law), it is better than nothing. But another answer goes back to the cost-benefit analysis I described earlier: we do not always want to stop corporations from harming people because sometimes the benefits to society outweigh the harms. What we do want, however, is for corporations to know they will pay for the harms before they decide to act so they only act when the benefits outweigh the harms. Class actions help corporations know that.

We law professors have not been misleading our students for the past 50 years: the theory of general deterrence is sound. We still

42. See *ibid*., 757.
43. George C. Eads and Peter H. Reuter interviewed corporate product safety officials and found "[o]f all the various external social pressures, products liability [lawsuits] ha[ve] the greatest influence on product design decisions," and also found that corporations deal with the uncertainty of liability by "monitoring the development of the law in many jurisdictions." *Designing Safer Products: Corporate Responses to Product Liability Law and Regulation*, Santa Monica, CA, RAND Corporation, 1983, pp. vii–ix. Similarly, when Andrew Popper conducted a survey of in-house counsel at Fortune 500 businesses, "73% [of respondents] agreed that a tort judgment against a company in the same line of commerce would prompt their company to 'examine methods of production … and, if needed, quietly take steps to make sure our products are in compliance…'" "In Defense of Deterrence", (2012) 75:1 *Albany Law Review* 197. E. Patrick McGuire's survey of 500 CEOs found similar results; lawsuits caused 35% of the surveyed CEOs to improve safety, 47% to improve warnings, 36% to close companies or discontinue products, 15% to lay off workers, and 8% to close plants. *The Impact of Product Liability*, New York, Conference Board Research Reports, 1988. Small business owners also report that fear of litigation has caused them to change their business practices; E. Christopher J. S. Hodges's survey of small businesses found that 26% said fear of liability kept them from releasing new products or services. *Law and Corporate Behavior: Integrating Theories of Regulation, Enforcement, Compliance and Ethics*,Portland, OR, Hart Publishing, 2015, p. 79.

have every reason to think that lawsuits—including class action lawsuits—deter corporate misconduct.

3. THE DATA ON GENERAL DETERRENCE

Thus far, my defense of general deterrence has been theoretical. It is a strong theory, as even many class action critics admit[44]—this, again, is why every law school teaches it to every incoming class of students every single year—but it is still a theory. Naturally, the critics of class actions have picked up on this fact. Thus, the last argument critics raise about deterrence is this one: the theory may be good, but you have no evidence that it actually works in practice.[45] Until we have some evidence, they suggest, we cannot assume class actions generate any deterrence. As Professor Linda Mullenix at the University of Texas puts it:

> [T]he deterrence theory suffers from a lack of empirical evidence and is based on conjectured hypotheses about corporate behavior … [S]ocial scientists have not been able to empirically measure … the deterrent effect of class litigation … Thus, judicial and scholarly arguments relating to the deterrent effect of class litigation are largely theoretical, conclusory pronouncements.[46]

This criticism is a bit unfair. We have a strong theory that class action lawsuits generate deterrence. The critics do not have a strong theory that they do not. If anyone should have the burden of coming up with some evidence, it should be the people without a theory, not the people with a theory.

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44. As Sheley and Frank concede, "it seems intuitive that the prospect of litigation might deter potential defendants from misconduct." "Prospective Injunctive Relief and Class Settlements", *supra*, note 11, 827.
45. See, for example, Michael S. Greve's claim: "we have strikingly little evidence that torts acts as a deterrent…" *Harm-Less Lawsuits?: What's Wrong With Consumer Class Actions*, Washington D.C., AEI Press, 2005, p. 16. Hodges expands on this line of argument: "There is almost no direct evidence on the actual effect of private enforcement of law, or on how litigation actually affects corporate decisions. The basic assumption is that since economic theory postulates that the imposition of a financial penalty will deter later wrongdoing, it must be so." *Law and Corporate Behavior*, *supra*, note 43, p. 67. Popper notes this line of argument in his study as well, writing that "the deniers believe there is insufficient empirical evidence to prove the power of deterrence…" "In Defense of Deterrence", *supra*, note 43, 195.
46. Linda S. MULLENIX, "Ending Class Actions as We Know Them: Rethinking the American Class Action", (2014) 64 *Emory Law Journal* 23.

But, in fact, there is indeed evidence that general deterrence works. There now are several studies of the theory. They span different time periods and involve different types of class actions, and, with one exception, they all say the same thing: class actions deter misconduct.

These are just the class action studies. There are far more studies showing that other types of lawsuits deter misconduct. These other studies are not as uncontroverted as the class action studies, but there are many, many more studies finding that lawsuits generate deterrence than finding that they don't. These other studies are important because, as I noted above, some of the arguments critics raise about the theory of deterrence are not specific to class action lawsuits: if the evidence shows corporate executives respond to the threat of individual lawsuits, then there is reason to think they respond to the threat of class action lawsuits, too. I will discuss these other studies after I discuss the class action studies:

But before I do, one note about these studies: many of them do not measure misconduct directly. That is because it is often impossible to measure misconduct directly. For example, it is impossible to observe whether companies are secretly conspiring with one another to fix prices—they do it in secret. Thus, most of the studies below measure deterrence by looking at proxies for misconduct rather than misconduct itself—for example, for price fixing, the studies look at whether prices go up or down. It's not perfect, but it is the best science can do right now. That is, that the best science can do suggests that lawsuits deter misconduct.

In 1981, several economists set out to examine whether increasing the threat of an antitrust enforcement action by the federal government deterred companies from price fixing.[47] The economists examined the white bread industry. They looked at the "markup" (the price above the price of the ingredients) on a loaf of white bread in various places in the United States between 1965 and 1976; the markup was their proxy for potential price fixing.[48] They compared these markups to the enforcement budget of the U.S. Department of Justice's Antitrust Division over time. They hypothesized that

47. See Michael Kent BLOCK, Fredrick Carl NOLD, and Joseph Gregory SIDAK, "The Deterrent Effect of Antitrust Enforcement", (June 1981) 89:3 *Journal of Political Economy* 429.
48. See *ibid*., 437.

the more money the federal government devoted to enforcement, the greater the threat of an enforcement action against price fixers; thus, if federal enforcement deterred price fixing, the markups would be smaller when the federal government's enforcement budget was bigger.[49]

That's not what they found. The federal government's enforcement budget had no effect on price markups until 1972; only then did a bigger budget lead to lower prices.[50] Why? The economists concluded that only after 1972 did companies face the threat of private antitrust class action lawsuits (only in 1966 was the modern money damages class action created) and *it was the private lawsuits that the companies were afraid of!*[51] They found that "settlements in class actions for price fixing in the bread industry were almost 10 times greater than government-imposed fines," and that "the deterrent effect of DOJ's enforcement efforts came not from the threat of publicly imposed fines or imprisonment, but from the likelihood of an award of private treble damages…"[52] In other words: "class actions represent the effective penalty in price-fixing cases."[53]

There have been several more recent studies, all of them concerning securities fraud class actions or their close cousins corporate derivate lawsuits, and, with one exception, all of them likewise finding that, the greater the threat of a class action lawsuit, the less corporate misconduct.

Two of these studies examined what happened when a U.S. Supreme Court decision in 2010 insulated some foreign companies from American securities fraud class action lawsuits. The securities fraud laws make it illegal for companies to misrepresent or hide relevant information from shareholders. When the threat of class

49. As Block, Nold and Sidak write, "[o]ur theoretical model suggests that increases in enforcement levels or penalties for price fixing generally reduce collusive markups." (*Ibid*., 434).
50. See *ibid*., 443. It should be noted that another economist found the DOJ's budget had a weaker deterrent effect when other variables were included in the analysis, but this study did not challenge the original findings regarding the class-action effect. See Craig M. NEWMARK, "Is Antitrust Enforcement Effective?", (1988) 96:6 *Journal of Political Economy* 1315.
51. Block, Nold and Sidak write that "only in the latter period, when class actions represented a credible threat, did a significant deterrent effect result…" *Supra*, note 47, 443.
52. *Ibid*., 440–41.
53. *Ibid*., 443.

action lawsuits went away, did the companies disclose less information to their shareholders than they had before? Both studies found that the answer was a resounding "yes": the threat of a class action lawsuit had induced the companies to be more forthcoming to their shareholders.[54]

A third study examined disclosures to shareholders over a larger set of companies and over a longer time period, 1996 to 2010.[55] The authors attempted to compare disclosure made by companies at a higher risk of facing securities fraud class actions to those at a lower risk; the authors identified which companies faced higher risks with a model that depended on the size of the company, the company's industry (e.g, was it a software company or a biotechnology company), and a host of other variables.[56] They found that companies at higher risk of being sued disclosed more information to shareholders, updated their disclosures more often, and rendered those disclosures in more readable language than companies at lower risk![57] They also examined whether this "disclosure gap" narrowed after 2005 when the Securities and Exchange Commission started requiring all companies—whether they were at high or low risk of being sued—to disclose all the same information on the forms they file every year with the federal government.[58] The authors found that the gap did indeed narrow when the companies no longer had any choice but to make the disclosures.[59] This means that, when the companies did have a choice, it was the threat of a securities fraud class action that made them do it.

A fourth study looked at what influenced corporate decisions to misrepresent their earnings to shareholders in the years 1997

54. See James P. NAUGHTON *et al.*, "Private Litigation Costs and Voluntary Disclosure: Evidence from the Morrison Ruling" (Working paper, last updated February 2017), online: <https://ssrn.com/abstract=2432371>. See also Anywhere SIKOCHI, "The Effect of Shareholder Litigation Risk on the Information Environment" (Working paper, Harvard Business School, last updated September 4, 2016), online: <http://www.hbs.edu/faculty/Publication%20Files/17-048_413e9658-649c-4904-8d49-6779f11910ac.pdf>.
55. Karen K. NELSON and A.C. PRITCHARD, "Carrot or Stick? The Shift from Vocabulary to Mandatory Disclosure of Risk Factors", (2016) 13:2 *Journal of Empirical Legal Studies* 266.
56. See *ibid*., online appendices A, B and C: <http://onlinelibrary.wiley.com/store/10.1111/jels.12115/asset/supinfo/jels12115-sup-0001-suppinfo.pdf?v=1&s=76449fae2e3ccb147074d3b2224d45fb071b5742>.
57. See *ibid*., 295.
58. See *ibid*., 267.
59. See *ibid*., 295.

through 2008. Did the fact that a company got sued in a securities fraud class action for earnings manipulation discourage *other companies* in that same industry or geographic region from manipulating their own earnings? Here again, after controlling for numerous other variables, the authors concluded that the answer was "yes": class actions deter misbehavior.[60]

A fifth study looked at whether corporate derivative liability deterred executives from introducing measures to entrench themselves in management. A corporate derivative lawsuit is much like a shareholder class action: one shareholder sues corporate executives, but instead of suing on behalf of other shareholders, the shareholder technically sues on behalf of "the corporation."[61] Beginning in 1989, roughly half of the states in America adopted a legal change that made it much more difficult to win a derivative lawsuit. When derivative liability went down in those states, did corporate executives adopt fancy measures (with names like "poison pills" and "blank check stock") to entrench themselves in management over the wishes of shareholders? You bet they did.[62]

Against these six class action studies, I have found only one study that points in the opposite direction. Three scholars examined whether American corporations disclose more information to shareholders than Canadian corporations do.[63] Because American securities fraud laws are more robust, that is what the deterrence theory would suggest. But they found precisely the opposite: more disclo-

60. See Simi KEDIA, Kevin KOH, and Shivaram RAJGOPAL, "Evidence on Contagion in Earnings Management", (2015) 90:6 *Accounting. Review* 2337, 2363-2367.
61. See Deborah A. DEMOTT and David F. CAVERS, *Shareholder Derivative Actions: Law and Practice*, Eagan, Minnesota, Clark Boardman Callaghan, September 2016, Westlaw edition.
62. The author, Ian Appel, found a higher use of anti-takeover provisions such as poison pills, blank check stock, classified boards, and supermajority voting requirements. "Governance by Litigation", available online: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2532278>, p. 21-22. He surmises that the decline of derivative liability led to these changes through channels of both specific and general deterrence: "First, the drop in the prevalence of litigation may lead to fewer settlements containing governance reforms. Second, weakened deterrence effects may lead managers to deploy governance provisions for the purpose of entrenchment…" *Ibid*., 23. Because the changes he observed occurred so quickly after derivative liability declined—i.e., too quickly for there to have been many derivative lawsuits filed and settled—he suspects the changes came about more from general than specific deterrence. *Ibid*.
63. Stephen BAGINSKI *et al*., "The Effect of Legal Environment on Voluntary Disclosure: Evidence from Management Earnings Forecasts Issued in U.S. and Canadian Markets", (2002) 77 *The Accounting Review* 25-50.

sure in Canada.[64] I do not put as much stock in this study as I do the others because it is very hard to do cross-country empirical studies; it is impossible to control for all the ways in which different countries differ from one another. And this study is directly contradicted by the several American-only studies, above, that show more liability leads to more disclosure. Nonetheless, for sake of completeness, I include this study here. But, as I said, it is the *only* contrary study I have found.

What about studies of other lawsuits? These studies are even more numerous. For decades and decades, scholars have studied the data on deterrence, and, for decades and decades, the studies have generally corroborated what the class action studies show: the threat of a lawsuit deters misconduct.

The studies outside the class action realm are too numerous to discuss comprehensively here. And not all of them deal with misconduct by corporations. But I will summarize them to give you a taste of what they say:

- *Tort liability and safety research*: scholars have found that the industries that face more tort liability spend more money researching safety measures for their products.[65]

- *Workers' compensation and workplace injuries*: scholars have found that, when the benefits employers would have to pay out for workplace injuries increased, fewer workplace deaths followed.[66]

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64. *Ibid*., 43-47.
65. Viscusi and Moore found that industries with higher tort liability loss ratios spent more on product-related research and development, and concluded that "tort liability does … have safety incentive effect." "An Industrial Profile of the Links Between Product Liability and Innovation", in *The Liability Maze*, *supra*, note 20, p. 114. However, Viscusi and Moore establish in other scholarship that this effect may taper off or become negative if liability grows too large. VISCUSI and MOORE, "Product Liability, Research and Development, and Innovation", (February 1993) 101:1 *Journal of Political Economy* 161-184. Furthermore, Viscusi's scholarship also casts doubt on the effectiveness of punitive damages, finding that they do not affect the incidence of chemical accidents, chemical releases, accident fatalities, or increase insurance premiums. "The Social Costs of Punitive Damages against Corporations in Environmental and Safety Tort", (November 1998) 87:2 *Georgetown Law Journal* 296–98.
66. See MOORE and VISCUSI, *Compensation Mechanisms for Job Risks: Wages, Workers' Compensation, and Product Liability*, Princeton, NJ, Princeton University Press, 1990, 133; James R. CHELIUS, "Liability for Industrial Accidents:

- *Bartender liability and alcohol-related traffic deaths*: scholars have found that, when liability was imposed on bartenders for inebriated driving by their patrons, fewer alcohol-related traffic deaths followed.[67]

- *Medical malpractice liability and negligence, deaths, and defensive medicine*: scholars have found that, when liability for medical malpractice decreases, doctors and hospitals spend less time and money on patients,[68] and more medical negligence and deaths follow.[69]

A Comparison of Negligence and Strict Liability Systems", (June 1976) 5:2 *Journal of Legal Studies* 303-306.

67. See SLOAN *et al.*, *Drinkers, Drivers, and Bartenders: Balancing Private Choices and Public Accountability,* Chicago, University of Chicago, 2000.

68. A number of scholars have found similar results supporting this conclusion. Daniel Kessler and Mark McClellan's research finds that medical malpractice reforms reduce hospital expenditures. "Do Doctors Practice Defensive Medicine?", (May 1996) 111:2 *Quarterly Journal of Economics* 353. Patricia M. Danzon has outlined the evidence indicating that liability induces physicians to spend more time per patient visit. "Liability for Medical Malpractice", (1991) 5:3 *Journal of Economic Perspectives* 62. Similarly, Donald N. Dewees *et al.* has outlined the evidence showing greater malpractice insurance premiums are associated with more diagnostic testing. *Exploring the Domain of Accident Law Taking the Facts Seriously*, New York, Oxford University Press, 1996, 104-105. However, there is scholarship that points the opposite direction. Danzon reviews the evidence that medical malpractice liability is negatively correlated with frequency of lab tests. "Liability for Medical Malpractice", *ibid*., 62. Michael Frakes recites conflicting studies on whether malpractice liability is associated with more c-sections, "Defensive Medicine and Obstetric Practices", (2012) 9 *Journal of Empirical Legal Studies* 457-462.

69. As with the previous footnote, a number of scholars have found results that support this conclusion, though this view is not unanimous. Zenon Zabinski and Bernard S. Black find that medical malpractice tort reforms increase the incidence of adverse outcomes other than death. "The Deterrent Effect of Tort Law: Evidence from Medical Malpractice Reform" (Working paper, Northwestern University, last updated February 15, 2015), online: <https://ssrn.com/abstract=2161362>. Michelle Mello and Troyen Brennan present evidence that liability for medical malpractice reduced negligence rates. "Medical Malpractice and the Tort System: What Do We Know and What (If Anything) Should We Do About It?" (2002) 80 *Texas Law Review* 1598. Joanna M. Shephard found that medical malpractice tort reforms increased deaths. "Tort Reforms' Winners and Losers: The Competing Effect of Care and Activity Levels", (2008) 55 *UCLA Law Review* 905. Paul C. Weiler *et al*. concluded that "the more malpractice suits that are brought … the fewer the number of negligent medical injuries", despite the fact that "this result did not reach the conventional level of statistical significance", *A Measure of Malpractice: Medical Injury, Malpractice Litigation, and Patient Compensation*, Cambridge, MA, Harvard University Press, 1993, p. 129. However, as in the previous footnote, there is scholarship that points in the other direction. Kessler and McClellan

- *Tort reform and traffic accidents*: scholars have found that, when liability for traffic accidents decreases, more traffic accidents follow.[70]

As I said, these studies are not uncontroverted, and I tried to cite opposing studies in the above footnotes.[71] But the important point is that the lion's share of studies *supports* the theory of general deterrence.

CONCLUSION

The primary justification for the class action lawsuit in the United States today is the deterrent effect it has on corporate misbehavior. In recent years, however, some critics have begun to

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found that malpractice tort reforms did not reduce mortality or medical complications. "Do Doctors Practice Defensive Medicine?", *supra*, note 68, 353. And Frakes and Anupam B. Jena find that malpractice tort reforms do not affect birth outcomes. "Does Medical Malpractice Law Improve Health Care Quality", (2016) 143 *Journal of Public Economics* 142-158.

70. Paul H. Rubin and Joanna M. Shepherd find that collateral source reforms increase vehicle accident deaths. "Tort Reform and Accidental Deaths", (2007) 50:2 *Journal of Law and Economics* 221. Michelle J. White finds that drivers take less care in comparative fault systems than in contributory negligence systems. "An Empirical Test of the Comparative and Contributory Negligence Rules in Accident Law", (1989) 20:3 *RAND Journal of Economics* 325–29. Michael L. Smith found that "[t]ests in the early studies produced mixed results, but later studies typically find that adoption of no-fault rules to replace common law tort liability leads to an increase in automobile accident fatality rates." "Deterrence and Origin of Legal System: Evidence from 1950-1999", (2005) 7 *American Law and Economic Review* 352. But see Rubin and Shephard's finding that other tort reforms than collateral source reforms decreased vehicle accident deaths. "Tort Reform and Accidental Deaths", 221. See also W. Jonathan Cardi *et al*.'s outline of conflicting studies on whether no-fault automobile accident compensation systems reduce or increase fatalities. "Does Tort Law Deter Individuals?: A Behavioral Science Study", (2012) 9 *Journal of Empirical Studies* 573-574, n. 31.

71. See also Robert A. Kagan's overview of the topic in *Adversarial Legalism: the American Way of Law*, Cambridge, MA, Harvard University Press, 2001, pp. 141-144. Some studies do not examine real-world data, but, rather, simulations, where survey takers are asked hypothetical questions about how they would respond to potential liability in certain situations. These studies have found mixed evidence of deterrence. See, for example, Cardi *et al.*'s finding that potential tort liability did not affect decisions to engage in potentially tortious behavior even though the threat of criminal sanctions did. "Does Tort Law Deter Individuals?: A Behavioral Science Study", *supra*, note 70, 567. Theodore Eisenberg and Christoph Engel found that damages liability deterred in public good experiments. "Assuring Civil Damages Adequately Deter: A Public Good Experiment", (April, 2014) 11 *Journal of Empirical Legal Studies* 301.

question even this justification. Some critics question the theory of general deterrence and others have said the theory lacks empirical evidence. But, as I have explained, the theory of deterrence is still sound. Moreover, there is in fact empirical evidence to support it, both for class actions as well as other lawsuits. As a result, I believe scholars and policymakers can still safely rely on deterrence as reason to retain class actions.

Can the Class Action Be Made Business Friendly?

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Formal adoption of a class action mechanism is under consideration in New Zealand. The United States has had a robust class action mechanism since 1966, but it is on the wane. The reason is big businesses have turned against it. In this essay, I explain why the business community dislikes the American class action and make some suggestions on how New Zealand might design its own class action to head off similar opposition.

1 INTRODUCTION

I understand that formal adoption of a class action mechanism is under consideration in New Zealand. We have had a robust class action mechanism in the United States since 1966, but it is on the wane in my country. The reason is largely because big businesses have turned against it. For many decades now, the business community has lobbied lawmakers to curtail the class action, but, with only limited success there, they have recently hit upon a do-it-yourself way to get around class actions: they put clauses in their contracts with consumers and employees requiring any dispute to be resolved by one-on-one arbitration. The business community hopes to be able to require shareholders to do the same one day. Any doubt about the lawfulness of most of this has been brushed aside by the Supreme Court of the United States in three decisions over the past decade, including one handed down earlier this year.[1] All signals in my country are that businesses will continue to "vote with their feet" and take more and more erstwhile class action litigation to individual arbitration. I explain all of this in a recent article.[2]

I do not know whether businesses will be able to get around any class action you create with arbitration clauses like they can in my country. There is an excellent article that has been accepted for publication in the New Zealand Law Review that tackles this issue head on.[3] But whether they can or they cannot, my point here is the same: if the business community hates your class action, then, even if you can get it off the ground, it will be constantly mired in political instability, and, eventually, the business community may very well find a way to do something about it like it did in my country. Thus, in this essay, I would like to explain to you why the business community hates the United States class action so much and make some suggestions on how you might design your own class action to head off similar opposition in your country. The objections I list below are not comprehensive; for that, you will need to read my forthcoming book.[4] Instead, I list below what I think are the most legitimate complaints businesses have against our system.

1 *AT & T Mobility LLC v Concepcion* 563 US 333 (2011); *American Express Co v Italian Colors Restaurant* 570 US 228 (2013); and *Epic Systems Corp v Lewis* 138 S Ct 1612 (2018).

2 Brian T Fitzpatrick "The End of Class Actions?" (2015) 57 Ariz L Rev 161.

3 Nikki Chamberlain "Contracting-Out of Class Action Litigation: Lessons from the United States" (NZLR forthcoming 2018).

4 Brian T Fitzpatrick *The Conservative Case for Class Actions* (University of Chicago Press, Chicago, 2019).

2 WE REGULATE BUSINESSES TOO MUCH

Let me begin with what I think is the most serious beef the business community has with our class action: it enforces substantive laws that businesses do not like. It is a sort of kill-the-messenger opposition: we do not like all these rules and regulations on us, but it is not politically possible to roll them back, so the second-best solution is to undermine the enforcement of the rules and regulations by making everyone litigate against us one-on-one.

The arbitration clauses that businesses use, however, are fairly indiscriminate: they force almost all disputes into one-on-one arbitration. The good laws, the bad laws, and the ugly laws. All must go to arbitration. But I think most people – even, in their candid moments, the business leaders themselves – would say there are at least some rules and regulations that we should force businesses to live by. For example, even the most conservative and libertarian of economists believe that we need laws against things like breach of contract, fraud, and price fixing. We cannot have free markets if people are allowed to cheat.

Thus, my first suggestion to you is this: there is no reason why class action lawsuits must be available to enforce every one of your laws. You can pick and choose. Perhaps you should start with the laws that have the most political support in your country and leave the other laws for consideration at a later date? In this way, you might build support for the class action in its early years by implementing it incrementally. We did not do that. Our rules of procedure are what we call "trans-substantive": they apply in all cases. This may have been a mistake with regard to the class action.

3 CLASS ACTIONS LEAD TO OVERDETERRENCE

One example of laws that are particularly ill-suited for the class action device is what we call "statutory damages" laws. "Statutory damages" in my country refer to monetary remedies that are fixed by statute for certain violations of the law; plaintiffs can recover these damages regardless of how much or how little they were injured by the defendant. Indeed, the entire point of these damages is often to set them much higher than the amount plaintiffs are injured.[5] A prominent example is the federal Telephone Consumer Protection Act of 1991.[6] The law says every single American is entitled to $500 (or even $1500 in some circumstances) every time a merchant uses a robo-dialer to call our cell phones without our permission.[7] Annoying as it is when companies do this to us, I think most would be hard pressed to say we are injured $500 every time this happens. So why did Congress give us more? To induce us to sue. Congress thought no one would sue if they could only get their actual damages; companies would therefore be able to use robo-dialers with impunity. In order to deter this misconduct, Congress gives us a bonus if we are one of the courageous ones who comes forward. Hopefully enough people would come forward to make companies think twice about doing this.

All this makes perfect sense in a world without class actions. If few people will sue when they are injured, give the ones who do a bonus and hope the bonuses add up to cover all the harm of the people who do not sue; that way companies know if they robo-dial people without their permission, they will have to pay the total amount of harm they cause; this gives companies the right incentives: they will only robo-dial if the

5 See Scheuerman's statement that: "Statutory damages allow a plaintiff to recover a prescribed sum in lieu of – or sometimes in addition to – actual damages. ... The Supreme Court has recognized the deterrent function of statutory damages, noting that statutory damages are designed 'to sanction and vindicate the statutory policy.' The very function of a minimum amount of damages is to add cost to the defendant's wrongful conduct.": Sheila B Scheuerman "Due Process Forgotten: The Problem of Statutory Damages and Class Actions" (2009) 74 Mo L Rev 103 at 110–111.

6 Telephone Consumer Protection Act 47 USC § 227.

7 § 227(b)(3)(B).

benefits to consumers outweigh the harm. This is the theory of deterrence-through-lawsuits. But in a world with class actions, there is no reason to give people bonuses any more. We don't need to induce people to come forward because, by definition, the class action includes everyone who has been robo-dialed by the defendant. If we give everyone a bonus – not just the select few who sued – the company will end up paying much, much more than it caused in actual harm. That is great if you want to indiscriminately put companies out of business; it is not so great if you want to induce companies to avoid harming people unless the benefits outweigh the harm.

When I say "indiscriminately put companies out of business" I am not exaggerating. I have seen robo-dial cases where all the phone calls would add up to over $1 trillion.[8] No company – not even Apple! – can pay that. It would not be socially desirable to put Apple out of business over some cell phone calls. We call this "over-deterrence". Companies complain that class actions lead to over-deterrence like this all the time.

I think there is some truth to this whenever "extra-compensatory damages" are recoverable in class action lawsuits. If you want to bring a robo-dial class action, you should not be able to recover any more than the class's actual harm; if you do not like that, then go ahead and sue one-on-one for $500 a call.[9] The same goes for so-called "treble damages" – i.e., tripling of actual damages – awarded under our antitrust and racketeering laws. And for punitive damages generally.

I understand that while New Zealand does not have treble damages, it has statutory damages in certain contexts (for example, as provided in the Credit Contracts and Consumer Finance Act 2003). I also understand that punitive, or exemplary damages, are available. My second suggestion to you is this: do not make extra-compensatory damages recoverable in class actions. They threaten not just deterrence, but over-deterrence.[10]

4 IT IS TOO DIFFICULT TO DISMISS MERITLESS CASES

Many corporations complain that class action cases are meritless, but they are forced to settle them nonetheless due to the expense and risk of defending class actions. I agree that class actions can be expensive and risky to defend – and I have some proposals to mitigate these problems below. But I do not agree that the cases companies are settling are meritless. Corporations have an inexpensive device to get rid of meritless cases at the very beginning in my country: the motion to dismiss. I understand you have a device like this, too, called the "strike-out application". In light of the motion to dismiss, when companies settle class action cases in my country, it should be because they have some merit. This does not mean that companies will not overpay to settle these meritorious cases due to litigation expenses and risk – that is

8 Tom Harvey "Jury finds Utah companies made 100 million illegal calls" *The Salt Lake Tribune* (online ed, Salt Lake City, 29 May 2016).

9 A variation on this idea is already found in some statutory damages laws: these laws allow individual recoveries or class action recoveries capped at a reasonable number, such as 1 per cent of a company's revenues or $500,000, whichever is less. See, for example, Fair Debt Collection Practices Act 15 USC § 1692k(a)(2)(B).

10 As John C Coffee Jr notes in *Entrepreneurial Litigation* (Harvard University Press, Cambridge (Mass), 2015) at 135:

> A context where the extortion thesis may make greater sense involves a combination of class actions and treble damages or other penalties. The purpose of punitive damages (including trebled damages) is to punish, not to compensate. But how much punishment is too much? When Congress authorized treble damages in the Sherman Anti-Trust Act in 1890, the modern class action did not then exist. Arguably, Congress would not want to punish at the astronomic level that the class action makes possible. Still, this critique implies only a limited reform, namely, that treble damages or other penalties should not be available in class actions.

See also Jason Scott Johnston "*High Cost, Little Compensation, No Harm to Deter: New Evidence on Class Actions under Federal Consumer Protection Statutes*" (2017) Colum Bus L Rev 1 at 68–69.

what I take up below – but it does mean that the notion that our system is overrun with meritless cases is not true.

In my estimation, there are only two circumstances where a company might pay to settle a meritless case despite the availability of the motion to dismiss. One is where the judge does not "stay" the litigation while the company's motion to dismiss is pending. It defeats the entire purpose of the motion to dismiss to make companies pay to continue litigating the case while the motion is pending; if the judge ends up dismissing the case, all of that money is wasted. I can understand why companies would settle meritless cases to avoid wasting that money. Most judges in our country stay the litigation while the motion to dismiss is pending, but some do not.[11] In my view, we should probably change our rules to make the stay mandatory. We have already done this for securities fraud class actions,[12] and we should probably do it for other class actions, too. My third suggestion is that you might wish to consider staying your class action litigation while strike-out applications are pending.

The other circumstance occurs when the judge makes a mistake and denies a motion to dismiss when he or she should not, thereby saddling companies with the choice of paying a lot of money to lawyers to defend the case or to settle instead. Judges, like the rest of us, are not perfect; they make mistakes too. We correct those mistakes by letting litigants appeal mistaken decisions to higher courts, but litigants in my country can usually do that only after the case is over.[13] That means a corporation would have to pay to go through all the other stages of a case – discovery, summary judgment, and trial – in order to appeal a mistaken opinion at the beginning. That is very expensive. Indeed, the fact that a judge might make a mistaken decision on the motion to dismiss is exacerbated by the ability of class action lawyers to do what we lawyers call "forum shop": like all lawyers, class action lawyers choose to file their cases in courts where they think the judges will treat them most favourably. That is, class action lawyers may seek out courts with very lenient attitudes toward motions to dismiss, thereby increasing the chance that a meritless case will slip through.

Although I am not sure how big a problem this really is – it is hard to find examples of ridiculous cases that survive a motion to dismiss in my country – we can do something about it if we think it is a problem. We can let corporations appeal decisions denying their motions to dismiss right away. Although we usually make litigants wait until the end to appeal in my country, sometimes we let parties appeal in the middle. We call this an "interlocutory appeal": the case is not over yet, but we pause it for a while to let the appeals court take a look at what the lower court did.

We have long been more willing to let parties take interlocutory appeals in class action cases.[14] Why? Because the expense and risk of a class action are so great, companies almost always settle these cases in the end, thereby denying an appellate court the opportunity to ever review what the lower court did.[15]

11 As Hartnett has noted, "Even when defendants move to stay discovery pending a motion to dismiss, some ... district courts deny the motion.": Edward A Hartnett "Taming Twombly: An Update after Matrixx" (2012) 75 Law & Contemp Probs 37 at 49.

12 See 15 USC § 77z-1(b)(1): "In any private action arising under this subchapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party."

13 See 28 USC § 1291: requiring a "final decision" from a District Court.

14 The Federal Rules of Civil Procedure have been revised to permit appeals of class certification decisions: Fed R Civ P 23(f). However, some lower courts permitted such appeals even before Rule 23 was revised. See *In re Rhone-Poulenc Rorer Inc* 51 F 3d 1293 (7th Cir 1995).

15 As the Seventh Circuit has noted, class certification forces "defendants to stake their companies on the outcome of a single jury trial, or be forced by fear of the risk of bankruptcy to settle even if they have no legal liability": *In re Rhone-Poulenc Rorer Inc* 51 F 3d 1293 (7th Cir 1995) at 1299.

It is true that allowing defendants to take an interlocutory appeal of denial of their motions to dismiss will delay class action cases; that is the downside to interlocutory appeals: piecemeal appeals make our system less efficient.[16] Nonetheless, class action cases are not such a big portion of our court system that permitting more interlocutory appeals would bog down our system very much.[17] At the same time, these cases are more important than the typical case, which justifies more judicial scrutiny.[18]

My impression of your system is that you allow more interlocutory appeals than we do in the United States, but still not from denials of strike-out applications. My fourth suggestion to you, then, is that you might consider allowing defendants to do so in class action cases.[19]

5 CLASS ACTIONS ARE TOO RISKY

As noted above, there may be some validity to the corporate concern that they pay more than they should to settle class action cases because defending class actions are so risky. Why? Because one judge or jury decides much or all of a class action trial in my country, and corporations risk a single judge or jury messing up not one person's claim, but thousands or even millions of people's claims. Thus, an extreme judge or jury could sock the company with millions or billions of dollars in damages – even if the average judge or jury would award nothing at all or only a small amount. Companies say that this forces them to settle cases rather than go to trial. Moreover, if class action lawyers know corporations have no choice but to settle, then class action lawyers can extract a premium from them during settlement negotiations: corporations will be willing to settle not only for what it believes the average outcome will be, but also some amount above that to avoid the unlikely possibility of the extreme outcome.[20] This is known in scholarly circles as "risk aversion".[21]

The problem with risk premiums is that they can lead to the same sort of over-deterrence I described above when discussing extra-compensatory damages: if corporations systematically pay more than the harm they cause, then we will end up chilling socially useful corporate activity – i.e., activity for which the benefits to society outweigh the harms. We want corporations to pay for the harm they cause, not less than that, and not more than that either. Risk aversion can force companies to pay too much.

Some scholars doubt that corporations are ever really willing to pay risk premiums.[22] These scholars note that corporations can buy liability insurance to pay any class action judgments against them, and,

16 The Supreme Court has explained that the "rule, that a party must ordinarily raise all claims of error in a single appeal following final judgment on the merits, serves a number of important purposes ... [including] promoting efficient judicial administration": *Firestone Tire & Rubber Co v Risjord* 449 US 368 (1981) at 374.

17 My empirical study of the federal courts found less than four hundred settlements per year: Brian T Fitzpatrick "An Empirical Study of Class Action Settlements and Their Fee Awards" (2010) 7(4) Journal of Empirical Legal Studies 811.

18 My empirical study found that the median value of most class action settlements was more than five million dollars (table 5): at 828.

19 There are other ways to enhance the early merits scrutiny in class action cases. See, for example, the proposal by Bone and Evans to assess whether a putative class action has merit before certifying it for class treatment: Robert G Bone and David S Evans "Class Certification and the Substantive Merits" (2002) 51 Duke LJ 1251.

20 As Schwartz observes, "The Chamber of Commerce and fellow business amici have repeatedly claimed that businesses are regularly forced to accept blackmail settlements in meritless cases to avoid the debilitating costs of discovery and the possibility of gargantuan judgments.": Joanna C Schwartz "The Cost of Suing Business" (2016) 65 DePaul L Rev 655 at 665. See also Coffee, above n 10, at 134; and Mark Moller *Controlling Unconstitutional Class Actions: A Blueprint for Future Lawsuit Reform* (Cato Institute, Cato Institute Policy Analysis No 546, June 2005) at 3.

21 As Silver notes, "The overpayment argument asserts that defendants facing class actions are risk averse.": Charles Silver "We're Scared to Death: Class Certification and Blackmail" (2003) 78 NYU L Rev 1357 at 1374.

22 Silver, above n 21, at 1414.

by definition, insurers are not risk averse: they are in the business of diversifying their risk exposure.[23] On the other hand, corporations are run by people, and the people may worry about their job security if the company has to pay a big judgment on their watch. Thus, corporate officials might be willing to pay risk premiums even though corporate shareholders may not want them to.[24] This is an example of what scholars call "agency costs": costs companies bear because their agents do things that are in the agents' best interest rather than the company's best interest. Although agency costs can be mitigated with well-designed employment contracts, I am not sure the willingness to pay risk premiums can be mitigated quite as easily as other agency costs can be. So, there may be some validity in the complaint that the riskiness of class actions leads companies to overpay to settle cases.

At the end of the day, I am not sure how big a problem corporate risk aversion really is. Even if corporations do exhibit risk aversion, class action lawyers can also be risk averse. Class action lawyers do not have as much insurance as corporations do and they put their livelihoods at risk when they take cases on contingency in a way that not even corporate officials do when they defend these cases. All this makes class action lawyers willing to accept too little to settle cases.[25] Thus, risk aversion may cancel itself out in the end.

Nonetheless, there is an easy way to make class action trials less risky, and I see little reason not to do it, for the good of both sides. How? By doing what statisticians call "sampling": instead of letting one judge or jury decide all the class's claims, we could randomly pick a small number of class members – maybe 10 or 20 – and try their claims individually before different judges or juries and then average the results over the rest of the class.[26] Companies would not be so afraid of trial if they had 10 or 20 chances; if one judge or jury did something really extreme, it would get averaged out by the others.[27]

Scholars have advocated sampling for many years,[28] and some courts in my country have tried it,[29] but our Supreme Court put a damper on the idea a few years ago in a case called *Wal-Mart Stores Inc v Dukes*.[30] The Court decried "Trial by Formula" and suggested using sampling could violate the due process rights of defendants.[31] But the sampling at issue in *Wal-Mart* – and the sampling that other courts have tried – is different than what I am proposing here. The courts that used sampling in the past did so to get around individual defences that defendants wanted to raise to particular class members' claims; these defences would have made the class action unwieldy, so courts blew past them by using sampling: they examined

23 At 1414.

24 See Richard Posner *Economic Analysis of Law* (9th ed, Wolters Kluwer Law and Business, New York, 2014) at 548–549.

25 Gilles and Friedman note that, "Class action plaintiffs' lawyers are indeed independent entrepreneurs driven by the desire to maximize their gain, even at the expense of class members' compensation.": Myriam Gilles and Gary B Friedman "Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers" (2006) 155 U Pa L Rev 103 at 104.

26 See, for example, Hillel J Bavli "Sampling and Reliability in Class Action Litigation" (2016) Cardozo L Rev de novo 207 at 207–208.

27 Bavli explains that "repeated adjudication may improve reliability … by averaging over multiple adjudications rather than relying on a single adjudication—and thus minimize error caused by judgment variability": at 218.

28 Tidmarsh urges a limited return to trial by statistics: Jay Tidmarsh "Resurrecting Trial by Statistics" (2015) 99 Minn L Rev 1459 at 1478–1479. Bone goes further arguing that "[s]tatistical adjudication through sampling can be a very useful procedural tool.": Robert G Bone "*Tyson Foods and the Future of Statistical Adjudication*" (2017) 95 NC L Rev 607 at 671.

29 See generally *Hilao v Estate of Marcos* 103 F 3d 767 at 782–784 (9th Cir 1996).

30 *Wal-Mart Stores Inc v Dukes* 564 US 338 (2011) at 356–357.

31 At 367.

individual defences in a few cases and then applied the results to other class members.[32] I am not proposing using sampling to facilitate class action treatment for cases that would otherwise be inappropriate for class action treatment. I am proposing sampling for cases that are otherwise appropriate for class action treatment. Nothing changes under my proposal except for the fact that, rather than one judge or jury deciding the class's claims, multiple judges or juries would do so. But if we are really worried that this might interfere with the due process rights of defendants, we could make my proposal available at the option of defendants: if they consent – and I see every reason why they should want to – then there can be no violation of their due process rights.[33]

I note that an alternative to "sampling" is to take a few "lead" or "bellwether" cases and try them individually and hope that the results might lead the parties to settle. We do something like this in the related cases that we consolidate for pretrial proceedings under our federal multi-district litigation statute. But I do not think the bellwether approach is as good as the sampling approach. Because the bellwether trial does not bind any of the other plaintiffs, parties can dismiss the bellwether results as unrepresentative in one way or another and ignore them. Indeed, in my country, more and more lawyers are contending that bellwether trials in multi-district litigation are pointless. Moreover, because, again, they are not binding, nothing is to stop one side of the litigation from trying bellwethers indefinitely, squandering any efficiencies the class action might promise us. Finally, it is well known that the parties can manipulate the bellwether process by voluntarily dismissing or settling the cases selected as bellwethers that they deem unfavourable to them. For all these reasons, my fifth suggestion to you is to use binding sampling rather than nonbinding bellwethers: average the results of a few trials and apply them to everyone else in the class.

6 CLASS ACTION LITIGATION IS TOO EXPENSIVE

As noted above, there may be some validity in the corporate concern that they pay more than they should to settle class action cases because defending class actions are too expensive.[34] Economists have shown that parties may settle litigation for more than they expect a judge or jury to award in order to avoid paying the litigation expenses that would be needed to get the case all the way through a trial.[35] For example, let us say a corporation believes the average judge or jury would award $1 million to the class if a class action case went to trial. But it would cost the corporation another $1 million to litigate the case. A rational company would be willing to settle this case for up to $2 million, even though, if the average award is an accurate reflection of the harm that the corporation caused, the company only caused $1 million in harm.[36] If companies systematically pay more than the harm they cause because of litigation expenses, then, again, we could end up with socially undesirable overdeterrence.

32 "Trial by statistics, of course, dispenses with proof of a causal connection for all the aggregated claims except for the sampled victims: the non-liability of the defendant to some unsampled class members is accounted for by reducing the average award. While this approach may get the aggregate liability of the defendant right, it fails to allow the defendant to prove that its conduct caused no harm to a given plaintiff.": Tidmarsh, above n 28, at 1476.

33 It should be noted that statistical sampling has long been used by administrative agencies to detect, for example, fraudulent Medicare and Medicaid claims without running afoul of the Due Process Clause of the Constitution. See Michael Sant'Ambrogio and Adam S Zimmerman "Inside the Agency Class Action" (2017) 126 Yale LJ 1634 at 1640, fn 14. Indeed, the more serious constitutional concern with my proposal may be that it violates the right to a jury trial in my country: the class members who are not randomly selected for the sample trials arguably do not get their claims decided by a jury because they are decided by the average of *other people's* juries.

34 Silver notes the view that, "The burdens of litigation, especially those relating to discovery and hearings on damages, are unmanageably great. A defendant's choice is therefore to settle or bear high litigation costs indefinitely.": Silver, above n 21 at 1363. See also Moller, above n 20, at 3; Schwartz, above n 20, at 11; and Coffee, above n 10, at 134.

35 Steven Shavell *Foundations of Economic Analysis of Law* (Harvard University Press, Cambridge, 2004) at 402–403.

36 Shavell, above n 35, at 402–403.

The same dynamic occurs on the plaintiff side: plaintiffs are willing to settle cases for less than the expected jury award to avoid their own litigation expenses. Thus, we might think that litigation expenses cancel each other out and result in settlements at the right price. But many scholars think that is not correct: defendants are thought to bear much greater litigation expenses than class action plaintiffs, and, for this reason, the settlement range is skewed against them.[37]

The main reason in our country why defendants are thought to pay so much more in litigation expenses than class action plaintiffs in the very same cases is because of a phase of our litigation called "discovery". In discovery, each side is given the opportunity to ask the other side for information. You can ask the other side to answer your questions. You can take testimony from the other sides' witnesses under oath. And you can ask the other side to turn over relevant documents to you.

It is that last item that drives up corporate discovery costs in my country. Corporations have lots and lots and lots of computer files and other data they have to look through to find all the documents class action lawyers ask them for. This creates perverse incentives: class action lawyers can ask for more and more and more, forcing defendants to pay more and more and more in litigation expenses, slowly driving up the settlement value of their cases.[38] Cannot corporations do the same thing to the class action lawyers? Ask them for more and more and more documents from class members? No: class action plaintiffs rarely have any documents at all to turn over. If you or I filed a class action against a company for fraud because something we bought was mislabelled, how many documents in our files at home or on our computer could we possibly need to find for the lawsuit? Maybe our store receipt showing we bought the product? The company we sued would have to look through billions upon billions of documents to find all the emails and other documents its employees circulated regarding that label we are suing about.

In other words, discovery leads to what I call "asymmetric litigation expenses," and, asymmetric litigation expenses lead to settlements that are over or under the expected trial outcome – in this case, above the expected outcome. As such, discovery expenses could lead companies to systematically oversettle cases, fostering more overdeterrence.

Thus, discovery expenses are a valid corporate concern in our country. My impression is that you do not permit discovery to the same extent we do.[39] As a result, you may not have to worry about asymmetric litigation expenses. But, even if asymmetric litigation expenses were possible in your country, you already have a solution to them: the loser-pays rule. The loser-pays rule makes both sides of the litigation worry about how much the litigation is costing their opponents. This tends to keep the expenses symmetric by making litigants think twice before they make their opponents do something.

I wish we would do more to share litigation expenses in my country like you do in yours. We can debate how much of each side's expenses should be shared, and whether they should be shared automatically in every case or only when one loses (like you do). I plan to discuss the various options at length in a forthcoming academic article. But the important point is this: some form of discovery-cost sharing could

37 This is because discovery is the largest part of litigation expenses, and as Judge Posner explains "[i]n most suits against corporations or other institutions, … the plaintiff wants or needs more discovery of the defendant than the defendant wants or needs of the plaintiff, because the plaintiff has to search the defendant's records (and, through depositions, the minds of the defendant's employees) to obtain evidence of wrongdoing.": *Swanson v Citibank N.A.* 614 F 3d 400 (7th Cir 2010) at 411 (Posner J, dissenting).

38 Easterbrook observes, "Litigants with weak cases have little use for bringing the facts to light and every reason to heap costs on the adverse party-on this supposition, the one in the right.": Frank H Easterbrook "Discovery As Abuse" (1989) 69 B U L Rev 635.

39 High Court Rules 2016, r 8.9.

go a long way toward mitigating asymmetric discovery costs and the overdeterrence that can result from it in my country.[40]

Some people in my country worry that class action lawyers will not have access to the necessary resources to pay even a portion of the defendants' discovery costs. It is true that class action lawyers do not have bank accounts as big as the corporations they sue. But class action lawyers have plenty of access to capital these days, whether from other lawyers, from banks, or from the burgeoning industry known as "third-party litigation finance".[41] I suspect you know about third-party finance even better than I do because your neighbour, Australia, pioneered it:[42] hedge funds and other investors are buying shares of lawsuits or extending non-recourse loans to class action lawyers and others.[43] In other words, if your lawsuit is profitable, someone these days will give you money to file and prosecute it. As you already know, cost sharing is hardly the end of the world.

7 A BUSINESS-FRIENDLY CLASS ACTION?

In my view, these are the most legitimate complaints that big businesses make against class actions. I do not doubt that taking them seriously will lead to fewer class actions and class actions that are more expensive for lawyers to prosecute. But it will not lead to zero class actions – far from it. You might consider keeping these complaints in mind as you begin your own history with the class action. Best of luck!

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40 Becker and Stigler propose "full compensation of persons acquitted of charges paid by the enforcement firms bringing these charges": Gary Becker and George Stigler "Law Enforcement, Malfeasance, and Compensation of Enforcers" (1974) 3 JLS 1 at 15. See also Coffee, above n 10, at 165–167; and Linda S Mullenix "Ending Class Actions as We Know Them" (2014) 64 Emory LJ 399 at 448–449.

41 See Brian T Fitzpatrick "Can and Should the New Third-Party Litigation Financing Come to Class Actions?" (2018) 19 Theo Inq L 109 at 111–113.

42 See Deborah R Hensler "The Future of Mass Litigation: Global Class Actions and Third-Party Litigation Funding" (2001) 79 Geo Wash L Rev 306 at 320–321.

43 Hensler, above n 42, at 320–321.