EXAMINATION OF LITIGATION ABUSES

HEARING

BEFORE THE

SUBCOMMITTEE ON THE CONSTITUTION
AND CIVIL JUSTICE

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

MARCH 13, 2013

Serial No. 113–8

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE

79–877 PDF WASHINGTON : 2013

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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EXAMINATION OF LITIGATION ABUSES

WEDNESDAY, MARCH 13, 2013

HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON THE CONSTITUTION AND CIVIL JUSTICE

COMMITTEE ON THE JUDICIARY

Washington, DC.

The Subcommittee met, pursuant to call, at 10:06 a.m., in room 2141, Rayburn Office Building, the Honorable Trent Franks (Chairman of the Subcommittee) presiding.

Present: Representatives Franks, Jordan, Chabot, King, DeSantis, Nadler, Conyers, and Deutch.

Staff Present: (Majority) Paul Taylor, Majority Counsel; Sarah Vance, Clerk; (Minority) David Lachmann, Subcommittee Staff Director; and Veronica Eligan, Professional Staff Member.

Mr. FRANKS. The Subcommittee on the Constitution and Civil Justice will come to order. Without objection, the Chair is authorized to declare a recess of the Committee at any time. Thank you all for being here.

The Subcommittee on the Constitution and Civil Justice meets today for a general oversight hearing to examine some current abuses in our civil justice system. It is appropriate that we hold such a hearing early in this Congress, so Members and the public can begin to understand the scope and nature of some of the more glaring dysfunctions in our litigation system before the Committee considers any potential legislation.

We have assembled a panel of witnesses here today who are particularly capable of surveying America's lawsuit landscape and identifying some of the biggest hills and gullies that threaten to make it even more difficult for hardworking Americans to get ahead.

Forum shopping, the practice by which lawyers can choose the judge that is most likely to side in their favor, remains a problem in America.

While the Class Action Fairness Act closed many loopholes that allowed abusive forum shopping, some courts have allowed trial lawyers to divide up their larger mass tort claims, so the smaller cases can continue to be tried in State courts, even when a Federal court remains the fairest forum for lawsuits involving citizens of different States.

Further, too many class actions are litigated today such that the victims of unlawful conduct often receive only pennies on the dollar, if anything at all, when their trial lawyer representatives amass millions of dollars in compensation.

Many times, the damages in class action lawsuits are so tiny that it is impossible to even identify the victims. In many such cases, awards are given to entities that are no part of the lawsuit whatsoever. Such awards called cy pres awards are often given to charities that support the trial lawyers' goals, but have no other connection to any victims. This is so even though nothing in Rule 23 of the Federal Rules of Civil Procedure, which allow class-action lawsuits, authorizes such awards.

Courts are then left to bypass the legislature and enrich third-party organizations of the trial lawyers choosing. This trend threatens both the Constitution's separation of powers requirements and its case and controversy requirement, which only allow courts jurisdiction over cases involving actual litigants.

Another problem that is becoming apparent is the increasing practice by which third parties fund litigation between others when such third parties have no other no connection to the substantive law of the case. When financial speculators with no substantive connection to a lawsuit fund litigation like they would any other speculative venture, existing problems in the American legal system are made much worse.

For example, as it is currently written, Rule 11 of the Federal Rules of Civil Procedure does not mandate that lawyers who file frivolous lawsuits be made to pay their victims for the cost of the frivolous litigation. Consequently, lawyers can file frivolous cases with virtual impunity.

That being the case, third-party litigation financiers can spread their risk, funding meritless cases as well as deserving cases in the hopes that one or more of the frivolous cases will yield a jackpot settlement so large it can potentially fund all the other cases as well.

On the other hand, the practice of third-party litigation financing can also deter the settlement of cases. This could happen when settlement offers are large enough to pay the lawyers and the victims they represent, but not large enough to also pay the lawsuit lenders the interest they charge on their loan.

These are just some of the issues our witnesses will explore today as the Subcommittee on the Constitution and Civil Justice begins its examination of lawsuit abuse.

And now with that, I will yield to the Ranking Member of the Subcommittee, Mr. Nadler from New York, for 5 minutes.

Mr. NADLER. Thank you, Mr. Chairman.

Mr. Chairman, we are back looking at the tort system again, and I see that the majority has again prejudged the issue with the title of this hearing. I know that we have long disagreed on issues affecting the tort system, but I had hoped that we could at least agree that a realistic understanding of how that system is functioning would entail a balanced look at both the costs and benefits of the system, and a more balanced look at the role that business defendants play in undermining the integrity of that system.

The fact is that tort law exists for several reasons, and perhaps this is as good a time as any to reflect on those reasons. First and foremost, it exists to compensate people for the harm inflicted on them by the negligence or intentional wrongdoing of someone else. That is especially important in a society where people still need to sue to get the medical care or to make up for the lost income or assets someone else's wrongdoing has necessitated.

Perhaps if we lived in a country where these matters were taken care of as a matter of national policy, we would not need to rely so heavily on the courts. But people who are harmed often have no recourse but to turn to the courts.

This is not malicious or predatory. It is, rather, a necessity and one that remains a pressing need as long as some in this country oppose universal health care coverage and a robust social safety net.

Second, the tort system exists to provide economic incentives to take the proper care not to harm others. Clearly, there are plenty of incentives to be reckless in ways that could cause serious harm. It costs money to make products safe or to make workplaces and public accommodations safe. There is the possibility of making big money by dealing dishonestly with investors who are selling defective goods.

The tort system balances the scales at least to some extent. It imposes a countervailing cost on misconduct. No one likes being sued, and that can have a beneficial effect on how people conduct themselves. Avoiding liability is often a matter of making a better product or conducting your business in a more open and honest manner.

Unless those who want to limit access to justice are prepared to have a truly strong regulatory and criminal framework for dealing with these problems, and I have seen little evidence of that, we must rely on the tort system to play a significant role in protecting the public interest.

The testimony we will hear today contains a great many complaints, and I will allow the witnesses to outline them. But I would note that there is no recognition in any of that testimony that, perhaps, the defendants in many of these cases actually were guilty of wrongdoing, that they may have had some obligation to compensate the victims of their wrongdoing, or that the public interest is served in requiring them to do so.

I would also note that missing from much of the testimony we will hear today is any recognition that defendants and their counsel sometimes engage in tactics to conceal facts from plaintiffs, to bury the plaintiffs in paper and expenses, and stretch out litigation in order to exhaust plaintiffs and their resources to keep up the fight.

There is almost no recognition that defendants may even have engaged in wrongdoing. Even where, as Ms. Milito does in her testimony, a defendant has admittedly broken the law, that defendant is cast still as a victim of lawsuit abuse.

In this case, the complaint has to do with admitted violations of the American with Disabilities Act. Congress specifically provided a private cause of action to ensure enforcement of that act. I suppose we could have sent an army of inspectors armed with tickets books to enforce the law, but I am not sure how Ms. Milito's organization would feel about that.

Many of the recommendations we will hear will have the effect of placing additional roadblocks in the path of people who have been genuinely harmed. By limiting fees, or eliminating contingency fees, or cutting off other sources of funding to allow individuals to hold their own in a case against corporations with seemingly endless resources, many of the proposals we will hear will, in effect, allow corporate malefactors to commit wrongdoing with impunity.

Not content with developments in the law, both legislatively and at the hands of the Supreme Court, we are hearing renewed calls to further limit access to the courts and to remedies like class actions.

In addition to congressional actions to limit access to justice, such as the Class Action Fairness Act, the Supreme Court's recent decisions have also greatly narrowed access to justice. In *Walmart v. Dukes*, the Court greatly limited class certification. In *AT&T Mobility v. Concepcion*, the Supreme Court held that the Federal Arbitration Act preempts State law on the unconscionability of class arbitration waivers in consumer contracts.

Finally, in *Ashcroft v. Iqbal*, the Court made it easier to dismiss cases based on a judge's own notions of plausibility prior to discovery.

Taken together, plaintiffs have really lost many of the rights they used to have to relief. I suppose the defense bar is entitled to demand still more, but the scales have already tipped radically in their favor.

I want to join the Chairman in welcoming our witnesses, and I look forward to their testimony.

I yield back the balance of my time.

Mr. FRANKS. And I thank the gentleman, and I will now yield to the Ranking Member of the full Committee, Mr. Conyers from Michigan.

Mr. CONYERS. Thank you, Mr. Chairman.

First of all, I want to welcome the witnesses, especially the director for the Center for Justice and Democracy at the New York Law School, attorney Doroshow.

I also commend and align myself with the remarks of the Ranking Member of the Subcommittee, Mr. Nadler.

I think that, in some respects, the title of this hearing is not as accurate as I would have made it, but one critical issue is the suggestion that we limit the ability of victims to pay for their cases. The proposal would eliminate or limit contingency fees, prevent attorneys general from retaining outside counsel, and prevent plaintiffs from seeking outside funding to sustain what are often long and costly cases.

Of course, the large corporate defendants realize this, and if they can limit the ability of their victims to fund the case, they can win through attrition and not on the merits.

And so here, with the sequester kicking in, and we are finding out now that there is talk of delaying jury trials, court security is being reduced, and now there is talk of federalizing everything, it sends a shiver down the spines of the judiciary, generally.

Now, we are supposed to be dealing with forum shopping, the cy pres doctrine, third-party financing. And the fact of the matter is, we have 33 vacancies that are being blocked by conservatives, in terms of making the Federal system work better than it is now.

Contingency fees, from my point of view, is the way the 99 percent are able to enforce their legal rights, even against the 1 percent.

And so, despite limits on class actions through legislation and Supreme Court decisions over the years, we still hear complaints that the plaintiffs still have an ability to bring their cases in State court. I realize that some consider the Federal courts a more favorable forum for corporate defendants, and will insist that Congress further trample on State rights and continue the Federal takeover of State tort law, which may be a direction we may be going in.

When you get past the rhetoric, it is clear that what is going on here is forum shopping through legislation.

While Members may not like State laws, the causes of action, the discretion exercised by State officials on the way to State courts and juries carry out their duties, and Congress should limit their interference in this kind of activity.

And finally, when we hear complaints about the victims and their attorneys, we hear little acknowledgment that many of these cases are, in fact, meritorious and that the individuals are entitled to compensation for their harm.

What are the victims in these cases supposed to do? They do not have money. Many of them aren't even going to be able to work anymore. And there is too little concern expressed about the extent to which large corporations, banks, and, may I mention, the Wall Street financial crowd—so far, there may be one person that has been sentenced to imprisonment that caused this tremendous economic destabilization. And here we find those who bankrupted pension funds, and the polluters destroyed the lives of millions of homeowners—are at the mercy of those who have caused some of the pollution and are now victims of discrimination.

And so I look forward to the testimony. I have no concern in which large corporations abuse legal process to conceal the truth and obstruct justice.

And this is a service. This is a goal that I will be listening carefully for.

And we may have to have another hearing, I say to the Chairman, to look at the other side of the issue.

And I yield back my time, and thank the Chair.

Mr. FRANKS. And I thank the gentleman.

Without objection, other Members' opening statements will be made part of the record.

And I will now introduce our witnesses.

Elizabeth Milito is a senior executive counsel for the National Federation of Independent Businesses' Small Business Legal Center. Ms. Milito has previously worked at the U.S. Department of Veterans Affairs, and as a trial attorney in Maryland, practicing in the fields of tort, medical malpractice, employment, and labor law. She has also clerked for the Honorable Alan Wilner on the highest State court in Maryland.

Welcome.

Ted Frank is this founder of the Center for Class Action Fairness. Mr. Frank has won several landmark cases and millions of dollars for consumers and other plaintiffs through the center, the nonprofit project he founded in 2009. He is also an adjunct fellow at the Manhattan Institute. Mr. Frank was a resident fellow with the American Enterprise Institute from 2005 to 2009, a litigator from 1999 to 2005, and he has clerked for the Honorable Frank H. Easterbrook on the Seventh Circuit Court of Appeals.

Thank you, sir.

Joanne Doroshow is the executive director of the Center for Justice and Democracy at New York Law School. Ms. Doroshow has worked on civil justice issues since 1986, when she directed an insurance industry and liability project for Ralph Nader. She has testified before the U.S. Congress many times and appeared before numerous State legislatures around the country.

Welcome, Ms. Doroshow.

John Beisner is the cochair of the mass torts and insurance litigation group at Skadden, Arps, Slate, Meagher & Flom LLP, based in its Washington, D.C., office. Among other things, that Mr. Beisner represents defendants in a wide range of aggregate litigation matters, including mass tort controversies, class actions, and False Claims Act suits.

Thank you for being here, sir.

So each of the witnesses' written statements will be entered into the record in its entirety. And I would ask that each witness summarize his or her testimony in 5 minutes or less. To help you stay within that time, there is a timing light in front of you. The light will switch from green to yellow, indicating that you have 1 minute to conclude your testimony. When the light turns red, it indicates that the witness's 5 minutes have expired.

So before I recognize the witness, it is the tradition of the Subcommittee that they be sworn, so if you will please stand to be sworn?

[Witnesses sworn.]

Mr. FRANKS. And I now recognize our first witness, Ms. Milito. Ms. Milito, is that microphone on? Ms. Milito, would you pull that microphone a little closer to you?

TESTIMONY OF ELIZABETH MILITO, SENIOR EXECUTIVE COUNSEL, NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB) SMALL BUSINESS LEGAL CENTER

Ms. MILITO. Thank you, Mr. Chairman, and distinguished Subcommittee Members.

NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses, and represents 350,000 member businesses nationwide. The typical NFIB member employs 10 people and reports gross sales of about $500,000 a year.

I applaud the Subcommittee for holding this hearing on the problem of lawsuit abuses. Although our country's judicial system has much to be lauded, small-business owners staring down a lawsuit find it hard to appreciate praise of the courts.

Of course, it is important to give victims of injustice their day in court. But lawsuit abuse victimizes those who are sued.

By lawsuit abuse, I am referring to those cases where a plaintiff's attorney asserts a flimsy claim to get some money, to get more money than is fair, or sues a business that had little or no involvement, but might have money. In all of those instances, small businesses must expend substantial resources to defend their business.

Lawsuits threatened or filed impact small-business owners. Small-business owners do not have in-house counsel to inform them of their rights, write letters responding to allegations made against them, or provide legal advice.

Today, I want to briefly discuss two areas that drive abusive litigation practices: one, financial incentives that encourage frivolous litigation; and two, fraudulent joinder.

The story of Doug Volpi, an NFIB member who owns a paint store in Southern California, provides a vivid example of litigation abuse and demonstrates how financial incentives encourage frivolous litigation. And I would like to say, too, Mr. Volpi was eager to have me share his story here today.

He received a summons in the mail notifying him that his business, Frontier Paint, was a defendant in an asbestos lawsuit. Mind you, the allegations in the claim stated that the plaintiff had been exposed to asbestos in the 1960's and 1970's from use of a product called Fixall. The manufacturer of Fixall has long since gone bankrupt.

Mr. Volpi bought his Southern California business in 1997. That was over 20 years after the plaintiff's alleged exposure. Moreover, the plaintiff lived in San Francisco, nowhere near the location of Mr. Volpi's Southern California store.

Upon receipt of the summons, Mr. Volpi said to his wife, we are going to need to hire a lawyer, and they did. Then Mr. Volpi himself spent hours online researching the plaintiff's claims and discovered that the plaintiff's attorney's law firm had a known reputation for trolling for defendant.

In Mr. Volpi's words, this attorney, "dropped a net, dragged it around, and pulled it up to see if there was any halibut."

Thanks to the work of Mr. Volpi's attorney, Frontier Paint did not become halibut. But dismissal of Mr. Volpi's business came at a significant cost to Frontier Paint.

Mr. Volpi and his wife paid significant legal fees out of pocket just to get their business removed from a complaint in which it should never been named as a defendant in the first place.

Mr. Volpi's story, unfortunately, is not unique. Class-action cases are rife with stories like Frontier Paint. In these cases, plaintiffs' attorneys use a shotgun approach. Hundreds of defendants are named in a lawsuit, and it is the defendant's responsibility to prove that they are not culpable.

Public policy should encourage plaintiffs' attorneys to prudently assess the viability of their clients' potential claims before they initiate a lawsuit and discourage plaintiffs from taking unfounded or improvidently cavalier positions.

Along these lines, we should aim to create strong disincentives against naming a small business as a defendant in a case where the claim against the business is particularly weak, especially where the plaintiff's apparent motive is to use the defendant as a body shield against invocation of Federal jurisdiction, or what is also referred to as fraudulent joinder.

But unfortunately, as the law currently stands, plaintiffs actually have perverse incentive to bring weak or attenuated claims against small business defendants for the sake of defeating Federal jurisdiction.

NFIB believes that we need to change the incentives driving our litigious culture. This may be accomplished, to some extent, through substantive reforms limiting tort liabilities or setting evidentiary or recovery standards.

But we should remember that the fundamental problem facing small-business owners in these cases is a lack of financial resources necessary to successfully fend off frivolous claims.

The cost of lawsuits for small businesses can prove disastrous and threaten the growth of our Nation's economy. We must work together to find and implement solutions that will stop this wasteful trend.

On behalf of America's small-business owners, I thank the Subcommittee for holding this hearing and for inviting me to testify here today.

Thank you.

[The prepared statement of Ms. Milito follows:]

Prepared Statement of Elizabeth Milito, Senior Executive Counsel, National Federation of Independent Business (NFIB) Small Business Legal Center

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB
The Voice of Small Business.®

House of Representatives Committee on the Judiciary
Subcommittee on the Constitution

on the date of

March 13, 2013

on the subject of

"Litigation Abuses"

Thank you, Mr. Chairman and distinguished Committee members for inviting me to provide testimony regarding the tremendous negative effects lawsuits, and particularly the fear of lawsuits, are having on the millions of small business owners in America today. My name is Elizabeth Milito and I serve as Senior Executive Counsel of the National Federation of Independent Business (NFIB) Small Business Legal Center. The NFIB Small Business Legal Center (NFIB Legal Center) is a nonprofit, public interest law firm established to provide legal resources and be the voice for small businesses in the nation's courts through representation on issues of public interest affecting small businesses.

The National Federation of Independent Business (NFIB) is the nation's leading small business association, representing members in Washington, D.C., and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate and grow their businesses.

NFIB represents 350,000 member businesses nationwide, and its membership spans the spectrum of business operations, ranging from sole proprietor enterprises to firms with hundreds of employees. While there is no standard definition of a "small business" the typical NFIB member employs 10 people and reports gross sales of about $500,000 a year. The NFIB membership is a reflection of American small business.

Although federal policy makers often view the business community as a monolithic enterprise, it is not. Small business owners have many priorities and often limited resources. Being a small business owner means, more times than not, you are responsible for everything – NFIB members, and hundreds of thousands of small businesses across the country, do not have human resource specialists, compliance officers, or attorneys on staff. For small business owners, even the threat of a lawsuit can mean significant time away from their business – time that could be better spent growing their enterprise and employing more people.

We would all like to think that attorneys comply with the highest ethical standards; unfortunately, that is not always the case. In my experience, this seems particularly true of plaintiffs' attorneys who bring lower-dollar suits – the type of suits of which small businesses are generally the target. In many instances, a plaintiff's attorney will just take a client at his word, performing little, if any, research regarding the validity of the plaintiff's claim. As a result, small business owners must take time and resources out of their business to prove they are not liable for whatever "wrong" was theoretically committed. As one small business owner remarked to me, "What happened to the idea that in this country you are innocent until proven guilty?"

Although that mantra refers to a defendant's rights in our criminal justice system, problems with our civil justice system can no longer be ignored. Although our country's judicial system has much to be lauded, small business owners staring down a lawsuit find it hard to appreciate any praise of the courts. Today I want to discuss three areas that help drive abusive litigation practices that threaten small businesses. These include the following: (1) the climate of fear that pervades America's Small Businesses; (2) financial incentives that encourage frivolous litigation; and (3) fraudulent joinder.

The NFIB Legal Center applauds the Committee for holding this hearing in order to focus on the problem of litigation abuses.

1. Lawsuits Create a Climate of Fear for America's Small Businesses

The verdict is in and it's not good. The country's legal climate is hurting the economy and costing the nation jobs. The United States is one of the most litigious nations in the world.

How bad is it? It's bad. Four in five voters (78 percent) believe there are *too many* lawsuits in the U.S.[1] More than 15 million lawsuits are filed every year.[2] While some of these lawsuits have merit, many do not and these lawsuits are costing each and every one of us.

And the news is particularly dire for small business owners. When a business is facing an abusive lawsuit, it is often far less expensive simply to settle the lawsuit rather than incur steep legal fees fighting it in court. While the targeted business saves money in the short term, these quick settlements encourage unscrupulous attorneys to continue shaking down small businesses with more lawsuits.

NFIB members, and the millions of small businesses across the country, are prime targets for these types of suits because they do not have the resources to defend against them. Small businesses cannot pass on to consumers the costs of liability insurance or pay large lawsuit awards without suffering losses.[3]

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[1] Americans Speak on Lawsuit Abuse, Conducted by Luce Research (August 2012), available at http://atra.org/sites/default/files/documents/ATRA%20SOL%20Voter%20Survey%20Summary%20FINAL.pdf.

[2] Joseph Shade, *The Oil & Gas Lease and ADR: A Marriage Made in Heaven Waiting to Happen*, 30 Tulsa L.J. 599, 656 (1995) ("More than 15 million lawsuits are filed every year in the United States. Between 1964 and 1984 the per capita rate at which law suits were filed tripled.") (citing Peter Lovenheim , Mediate, Don't Litigate 3 (1989)).

[3] Damien M. Schiff and Luke A. Wake, *Leveling the Playing Field in David v. Goliath: Remedies to Agency Overreach*, 17 Tex. Rev. L. & Pol. 97, 98-99, 109-113 (2012) (discussing the financial difficulties facing small business owners when legal problems arise, and the financial disincentives against protecting their legal rights).

The costs of tort litigation are staggering, especially for small businesses. The tort liability price tag for small businesses in 2008 was $105.4 billion dollars.[4] Small businesses shoulder a disproportionate percentage of the load when compared with all businesses. For example, small businesses pay 81 percent of liability costs but only bring in 22 percent of the total revenue.[5] It is not surprising that many small business owners "fear" getting sued, even if a suit is not filed.[6]

That possibility – the fear of lawsuits – is supported by an NFIB Research Foundation National Small Business Poll, which found that about half of small business owners surveyed either were "very concerned" or "somewhat concerned" about the possibility of being sued.[7] The primary reasons small business owners fear lawsuits are: (1) their industry is vulnerable to suits; (2) they are often dragged into suits in which they have little or no responsibility; and (3) suits occur frequently.[8]

As I have stated – lawsuits (threatened or filed) impact small business owners. In nine years at NFIB, I have heard story after story of small business owners spending countless hours and sometimes significant sums of money to settle, defend, or work to prevent a lawsuit. And while our members are loath to write a check to settle what they perceive to be a frivolous claim,[9] they express as much, if not more, frustration with the time spent defending against a lawsuit. In the end, of course, time is money to a small business owner.

We must remember that small business owners do not have in-house counsels to inform them of their rights, write letters responding to allegations made against them, or provide legal advice. Without a standing army of attorneys ready to address legal problems, small business owners are more vulnerable to lawsuits, as they often delay seeking counsel—for financial reasons—until a lawsuit has already been filed. And in many cases the business simply lacks the resources needed to hire an attorney or—for that matter—the time and energy that may be required to fight a lawsuit. These factors make small businesses particularly vulnerable targets for plaintiffs seeking to exact an easy settlement.

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[4] "Tort Liability Costs for Small Businesses," U.S. Chamber Institute for Legal Reform, 2010, at 11. In its most recent report, "2009 Update on U.S.Tort Cost Trends,"Tillinghast/Towers Perrin forecast that tort costs would reach $183.1 billion in 2011 for all businesses with NERA Economic Consulting estimates that, in 2011, $152 billion will fall on small businesses.

[5] *Id.*
[6] *Id.* at 7-8.
[7] NFIB National Small Business Poll, "Liability," William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 2 (2002).
[8] *Id.* at 1.
[9] For the small business owner with 10 employees or less, the problem is the $5,000 and $10,000 settlements, not the million dollar verdicts. When you consider that many of these small businesses only net $40,000 - $60,000 a year, $5,000 paid to settle a case immediately eliminates about 10 percent of a business' annual profit.

Of course, it is important to give victims of injustice their day in court. But lawsuit abuse victimizes those who are sued. And by lawsuit abuse, I'm referring to those claims where a plaintiff's attorney asserts a flimsy claim to get some money, to get more money than is fair, or sues a business that had little or no involvement but might have money. In all of these instances, small businesses must expend substantial resources to defend the business or risk the prospect of default judgments against them.

But there are other costs as well; the time and energy wasted defending meritless claims and the damage to an innocent business's reputation which is not automatically remedied just because the claim is successfully defended or dismissed.

In addition to the financial costs of settling a case, there are incalculable psychological costs. Small business owners threatened with lawsuits often would prefer to fight in order to prove their innocence. They do not appreciate the negative image that a settlement bestows on them or on their business. Settling a meritless case causes the business to look guilty, and some prospective customers cannot be easily convinced otherwise. Yet, unfortunately, the reality is that small business owners often have no choice but to settle, accept their losses and try to move on when threatened with a lawsuit.

Of course, for those small business owners who chose to stand on principle when they know they are in the right, there is no easy road. To vindicate their rights, they must prove their innocence in court. The NFIB members to whom I have spoken almost universally state that defending a meritless suit occupies their daily attention and costs them many sleepless nights.

2. <u>Financial Incentives Encourage Frivolous Lawsuits</u>

I have previously testified before this committee, explaining that frivolous lawsuits come in all shapes and sizes. This remains as true today as ever before. And it will remain true so long as plaintiffs' attorneys are incentivized to move forward with questionable claims. And while I think we all recognize the nationwide problem of frivolous litigation; it is important to remember that behind each case there are real stories. These suits impact real people and they threaten real jobs.

One of the most prevalent forms of lawsuit abuse occurs when plaintiffs or their attorneys are merely trolling for cases. A plaintiff, or an attorney, will travel from business to business, looking for violations of a particular law. In such cases, the plaintiff generally is not as concerned with correcting the problem as he or she is in extracting a settlement from the small business owner. In many instances the plaintiff's attorney will initiate the claim, not with a lawsuit, but with a "demand" letter. In my experience, plaintiffs and their attorneys find "demand" letters particularly attractive when they can file a claim against a small business owner for violating a state or federal statute.

The scenario works as follows: an attorney will send a one and a half to two-page letter alleging the small business violated a particular statute. The letter states that the business owner has an "opportunity" to make the whole case go away by paying a settlement fee up front. Time frames for paying the settlement fee are typically given. In some cases, there may even be an "escalation" clause, which raises the price the business must pay to settle the claim as time passes. So, a business might be able to settle for a mere $2,500 within 15 days, but if it waits 30 days, the settlement price "escalates" to $5,000. Legal action is deemed imminent if payment is not received.

In California, attorneys have been known to rake in several million dollars a year fleecing small business owners. One particular attorney, Harpreet Brar, received hundreds of settlements of $1,000 or more from "mom and pop" stores throughout the state after suing them for minor violations of the state business code. Mr. Brar sued many of these businesses for allegedly collecting "point-of-sale" device fees from his wife without proper disclosure signs.

Doug Volpi, an NFIB member who owns a paint store in Southern California, provides a vivid example litigation abuse. He received a summons in the mail notifying him that his business Frontier Paint was a defendant in a multi-million dollar asbestos lawsuit. Mind you, the allegations in the complaint stated that the plaintiff had been exposed to asbestos in the 1960s and 1970s from use of a product called "Fixall." The manufacturer of Fixall has long since gone bankrupt leaving small businesses who allegedly sold the product holding the bag. Mr. Volpi bought his Southern California business in 1997 – over twenty years after the plaintiff's alleged exposure. Moreover, the plaintiff lived in San Francisco nowhere near the location of Mr. Volpi's Southern California store.

Upon receipt of the summons – Mr. Volpi first panicked, then he went to work. According to Mr. Volpi as soon as he read the papers he said to his wife "we're going to need to hire a lawyer." And they did. Then Mr. Volpi himself spent hours on-line researching the plaintiff's claims and discovered that the plaintiff's attorney's firm had a known reputation trolling for defendants. In Mr. Volpi's words this attorney "dropped a net, dragged it around, and pulled it up to see if there was any halibut." Thanks to the work of Mr. Volpi's attorney – Frontier Paint didn't become halibut. But dismissal of Mr. Volpi's business came at a significant cost to Frontier Paint. Mr. Volpi and his wife paid what was to them significant fees just to get their business removed from a complaint in which it should never have been named in the first place.

Mr. Volpi's story, unfortunately, is not unique. Class action cases are rife with stories like Frontier Paint's. In these cases, plaintiffs' attorneys use a shotgun approach - hundreds of defendants are named in a lawsuit, and it is the defendants' responsibility to prove that they are not culpable. In many cases, plaintiffs name defendants by using vendor lists or even lists from the Yellow Pages of certain types of businesses (e.g., auto supply stores, drugstores) operating in a particular jurisdiction.

Another NFIB member has been targeted in asbestos litigation. The family-owned commercial construction business, which was founded over 40 years ago, has been named in over 10 asbestos lawsuits. According to the member, his company has been targeted in recent years as many asbestos manufacturers have gone bankrupt leaving a void of solvent defendants. As a result, attorneys are now trolling for construction firms that existed in the 1960s, that are still in existence, and preferably with deep pockets, today.

The NFIB member, who wishes to remain anonymous for fear publicity surrounding his company's involvement in asbestos litigation will cause more attorneys to target the business, has never been sued by an employee – all suits have been filed by individuals who allege that the NFIB member company was one of potentially dozens of subcontractors on a particular job site where the plaintiff worked and was allegedly exposed to an asbestos product. In several instances, it was later shown the plaintiff could never have worked at a site alongside the NFIB member, such as when exposure allegedly occurred at a marine construction site or before the company even existed. Still, to get dismissed from these cases the NFIB member spends thousands of dollars in attorney's fees and discovery costs.[10]

Substantive reforms limiting tort liabilities or setting evidentiary and recovery standards would certainly help disincentive plaintiffs' attorneys from taking brash and cavalier legal positions. But, in crafting solutions here, we must acknowledge the practical circumstances of the small business owner threatened with protracted legal battle. Regardless of whether the plaintiff's claims are meritorious, the small business defendant faces a difficult—and often impossible—dilemma.

Calculating attorneys know that they can often exact settlements from small businesses simply by holding the threat of a lawsuit over the business. This is true of larger businesses to a certain extent as well; however, we must remember that the typical small business operates on razor thin margins and maintains fewer assets than larger businesses. Small businesses simply cannot absorb the costs of a legal battle as easily as larger businesses—or for that matter the cost of paying damages if they should lose in the end.

This means that—in many cases—the small business owner may be risking financial ruin if the owner refuses to settle. And the plaintiffs' bar knows that most

[10] *See also As Asbestos Claims Rise, So Do Worries About Fraud*, THE WALL STREET JOURNAL, March 11, 2013 (discussing increase in fraudulent asbestos claims and the impact of asbestos-related manufacturers' bankruptcies on remaining solvent businesses).

small business owners realize that the costs of fighting a legal battle often outweigh the benefit to be had in mounting a defense. Indeed, at the NFIB Legal Center, we regularly speak with small business owners facing serious legal issues, who are nonetheless hesitant to seek out legal counsel because they know that attorney fees are extremely costly. They also know that litigation is always a gamble, no matter how outlandish a lawsuit may be.

Just last week, we spoke with a small business owner in Florida who has been dealing with an ongoing legal battle for the last four years in case that he believes is entirely frivolous. Mr. Scott Schroeder runs a modest business as a contractor, but he says he is about to go out of business because he has incurred over $20,000 in attorney's fees trying to defend his business from a wrongful claim. He said, "If I get to court, I will win. But, I don't have any money left… They are just trying to drain me because they know I won't be able to afford it because it's just been going on too long."

Today Mr. Schroeder says that it probably didn't make sense in terms of dollar-and-cents to fight to defend against this suit, but he wanted to stand on principle because he says "it just isn't right" to give in to a wrongful lawsuit. Unfortunately, if he cannot resolve this case soon, or procure an attorney who can take this case on *pro bono*, he will likely go out of business or be forced to settle after already sinking substantial resources into the fight. Sadly, this is the plight of most small business owners in these sorts of cases.

Since there is no guarantee that, at the end of the fight, the defendant will prevail, small business owners often rationally opt to avoid the costs of litigation by agreeing to settle claims that they believe to be without merit. For example, one small business owner, who wishes to remain anonymous, recently told us about a messy lawsuit that has cost his business over $500,000 in legal fees—more than $400,000 above what his attorney's originally estimated the case would cost to litigate. Unfortunately for this business owner, there is no apparent end in sight. And in cases like this where protracted legal battles result in staggering legal bills, business owners are often forced to fold—regardless of how strong their position may be from a legal standpoint.

Most small business owners seek to avoid these sorts of open-ended financial liabilities by settling up-front. Indeed they will rationally decide to settle in cases where they realize that the probable cost of litigation will exceed the benefit of winning in court. Moreover, even the threat of a lawsuit will require small business owners to expend time and energy dealing with the issue. Furthermore, lawsuits inevitably cause stress and an emotional toll on small business owners.

For these reasons, plaintiff attorneys have a perverse incentive to threaten or initiate a legal action, even when the plaintiff has only an outside chance of recovery in court. They know that the majority of cases settle, and that even outlandish claims sometimes "stick" in court. So why not move forward with questionable claims? Indeed, this perverse incentive is the root cause of litigation abuse. And it remains a nationwide problem both in terms of the economic impact it has on business and in terms of the culture of fear that it fosters in the business community.

3. Perverse Incentives for Fraudulent Joinder

As I have explained, in many cases overly aggressive plaintiff attorneys will target small businesses with an aim to force a settlement or in the hope that one of their claims might "stick" in court. But in other cases small businesses are named as defendants because they represent convenient targets for the purpose of forum shopping. In these cases small business owners are forced to incur substantial financial costs in defending their business, they must dedicate their time and energy to the case, and they must deal with the heavy emotional toll that a wrongful suit may cause—all because they have been named as a defendant for an improper reason.

Public policy should encourage plaintiffs' attorneys to prudently assess the viability of their clients' potential claims *before* initiating a lawsuit and discourage plaintiffs from taking unfounded or improvidently cavalier positions. Along these lines, we should aim to create strong disincentives against naming a small business as a defendant in a case where the claim against the business is particularly weak, especially where the plaintiff's apparent motive is to use the defendant as "body-shield" against invocation of federal jurisdiction. But unfortunately, as the law currently stands, plaintiffs actually have perverse *incentive* to bring weak or attenuated claims against small business defendants for the sake of defeating federal jurisdiction.[11]

The plaintiffs' bar knows that frivolous suits are much more likely to be dismissed in federal court.[12] Accordingly, plaintiffs' attorneys usually seek to file in state court and they draft their complaints with an aim to prevent defendants from removing to federal court.[13]

On the other side of the equation, defendants prefer to be in federal court because federal courts tend to have a better grasp on the issues and the proper procedures, and because there is more predictability in federal courts.[14] Thus out-of-state defendants often seek to remove tort cases from state to federal court. They are entitled to do so under federal law, provided that there is

[11] *See* Melissa R. Levin and Heather K. Hays, ***Fraudulent Joinder: Successful Removal of Actions to Federal Court***, Pharmaceutical & Medical Device Law Bulletin, Vol. 4, No. 4 (April, 2004).
[12] Plaintiffs' success rate is only 34 percent in federal court after removal. Matthew J. Richardson, *Clarifying and Limiting Fraudulent Joinder*, 58 Fla. L. Rev. 119, 183 (2006)
[13] John Merrill Gray, III, *Motions—Refining the Standard in Motions in Alleging Fraudulent Joinder*, 36 Am. J. Trial Advoc. 225, 231 (2012) ("Joining an in-state defendant to defeat diversity is a common tool used by parties seeking to remain in state court.").
[14] *See* Levin and Hays, *supra* at 1.

"complete diversity" between the defendants and the plaintiff.[15] In other words, removal is allowed only where *all* of the defendants are from a different state than the plaintiff.[16] For example, a case may be removed from Kentucky State court where the defendant corporations are based in New York and California.

Accordingly, an aggressive plaintiff's attorney—always employing new and ingenious forum-shopping games—has a strong incentive to find someone else to name as a defendant in the plaintiff's home-state. In the foregoing example, the Kentucky plaintiff has a much better chance of prevailing if he or she can add a Kentucky defendant to the suit because this will most likely ensure that the case will remain in state court.

Knowing that the plaintiff is more likely to prevail in state court, the plaintiff's attorney has an incentive to name another defendant, even if he or she can only muster a weak or attenuated claim. And this is often going to be a local small business that had only a tangential or peripheral role in the case or controversy at issue because they are convenient target.[17] For example, in a typical products liability case, the plaintiff will be suing an out-of-state manufacturer on the theory that the manufacturer was negligent in designing the product. In such a case, the local merchant who sold the product is a convenient defendant—not necessarily because the plaintiff intends to hold the merchant liable so much as because the plaintiff wants to prevent the manufacturer from removing the case to federal court. But, once more, we maintain that the plaintiff should not be incentivized to drag a small business owner into litigation for such a Machiavellian purpose.

In theory the out-of-state manufacturer in such a case could seek to remove the case to federal court on the ground that the plaintiff fraudulently joined the local merchant as a defendant simply for the purpose of defeating federal jurisdiction.[18] But, this is generally an uphill battle for the defendant.[19] To avoid remand back to state court, the defendant must demonstrate that the plaintiff falsely or fraudulently misstated facts in adding the in-state defendant or that there is no chance of the defendant prevailing.[20]

While the federal courts vary in how they approach this issue, the differences between the circuits pertain to deference provided to the plaintiff.[21] This means that, in the best case scenario, it is going to be hard for a defendant to prevail. Indeed, plaintiffs predominantly succeed in getting federal courts to remand

[15] *See* 28 U.S.C. § 1332(a)(1) (2005) (stating that the district courts have original jurisdiction over all cases and controversies between citizens of different states).
[16] Richardson, *supra,* at 166.
[17] *See e.g.*, Gray, *supra* at 225-227 (discussing the facts of a case where out-of-state defendants were prevented from removing their case to federal court because the plaintiff also named a local landlord was as a defendant).
[18] *See* Levin and Hays, *supra* at 1.
[19] *See* Richardson, *supra* at 133-34.
[20] *Id.*
[21] *Id.*

these cases back to state court.[22] Courts generally remand any case if the plaintiff might prevail in his or her claim against the in-state defendant.[23] This plaintiff-friendly standard only emboldens plaintiffs to aggressively name local defendants even when there are serious questions as to their likelihood of success in the end.

Moreover, plaintiffs are further incentivized to proceed with questionable claims—and for the purpose of avoiding federal jurisdiction—by naming local small business defendants because federal statutes prevent defendants from appealing when a federal court remands a case back to state court.[24] And, conversely, courts give plaintiffs an unfair advantage over defendants because the plaintiff can appeal if the federal court holds that the in-state defendant was inappropriately joined.[25]

Finally, federal statutes discourage defendants from challenging a fraudulent joinder because the plaintiff can collect attorney's fees if the challenge fails.[26] Here again, plaintiffs are given an unfair advantage over defendants because defendants *are not* entitled to seek attorney's fees if they prevail in convincing the federal court that the in-state defendant was fraudulently joined.[27] Accordingly, plaintiffs have little to lose and much to gain from naming another defendant—even if they are climbing out on a limb in doing so. Federal statutes have thus created all of the wrong incentives here.

Solutions for Small Business

To fulfill our role in representing the interests of the small business community in the nation's courts, the NFIB Legal Center filed over 40 amicus briefs on a whole host of issues last year, including in cases where aggressive plaintiffs sought to set a precedent that would have exposed small business owners to new or greater liabilities for alleged torts. And we anticipate the need to continue filing in these sort of cases to defend small business interests because the plaintiffs' bar continues to push the proverbial envelop in encouraging courts to adopt expansive tort liability rules. Personal injury attorneys advocate rules that will open small businesses up to new and expanded liabilities because they are

[22] *Id.* at 134 ("The removing defendant bears a heavy burden to show fraudulent joinder, and the burden is heavy in large part because issues of both law and fact are to be resolved in favor of the plaintiff.").
[23] *Id.*
[24] *Id.* at 134 -135 (If defendants lose on the motion to remand, they are left without a remedy because the order cannot be appealed, pursuant to federal statute.) (citing 28 U.S.C. § 1447(d) (2005)).
[25] *Id.* at 138 ("If the motion is denied, then the order may be appealed after final judgment, and the district court may proceed to dismiss the non-diverse defendants under Rule 21.").
[26] *Id.* at 134 ("Even worse, if defendants lose on the motion to remand, the district court is empowered by federal statute to award costs to the plaintiffs.") (citing 28 U.S.C. § 1447(c)).
[27] *See* 28 U.S.C. § 1447(c) (stating that "[a]n order remanding the case may require payment of just costs and any actual expenses, including attorney fees, incurred as a result of the removal").

looking for more parties to hold liable and to make it easier to prevail in their cases.

For these reasons, NFIB Legal Center maintains that it is imperative that we change the incentives driving our litigious culture. This may be accomplished to some extent through substantive reforms limiting tort liabilities or setting evidentiary and recovery standards. But, we should remember that the fundamental problem facing small business owners in these cases is a lack of financial resources necessary to successfully fend off frivolous claims.

Given the tremendous costs of litigation, and the inevitable risk that a plaintiff might prevail if the case goes before a sympathetic jury or an errant judge, we must also address the reality that small business defendants are rationally discouraged from vindicating their rights. And so long as this remains true, plaintiffs' attorneys will inevitably weigh the benefits of pursuing a questionable claim as outweighing the risks.

Accordingly, we encourage the adoption of rules that encourage plaintiffs to make prudent decisions and that discourage them from taking cavalier and abusive positions in litigation. And we should promote policies that encourage defendants to stand up for themselves when they are wrongly accused or inappropriately named as a defendant.

Conclusion

Lawsuits hurt small business owners, new business formation, and job creation. The cost of lawsuits for small businesses can prove disastrous, if not fatal, and threaten the growth of our nation's economy by hurting a very important segment of that economy, America's small businesses. We must work together to find and implement solutions that will stop this wasteful trend. On behalf of America's small business owners, I thank this Committee for holding this hearing and providing us with a forum to tell our story.

We are hopeful that through your deliberations you can strike the appropriate balance to protect those who are truly harmed and the many unreported victims of our nation's civil justice system – America's small businesses.

Sincerely,

Elizabeth Milito, Esq.
NFIB Small Business Legal Center

Mr. FRANKS. Thank you, Ms. Milito

And I will now recognize our second witness, Mr. Frank. And please turn on your microphone, sir.

TESTIMONY OF THEODORE H. FRANK, ADJUNCT FELLOW, MANHATTAN INSTITUTE FOR LEGAL POLICY, PRESIDENT, CENTER FOR CLASS ACTION FAIRNESS

Mr. FRANK. Thank you, Mr. Chairman, and distinguished Committee Members, for inviting me to provide testimony about class-action settlement abuse and, in particular, cy pres.

My nonprofit public interest law firm, the Center for Class Action Fairness, has won millions of dollars for what the Ranking Member called the victims—consumers and shareholder plaintiffs—by representing objectors to unfair class-action settlements.

And while I am affiliated with the center and with the Manhattan Institute, I am not speaking on their behalf today, but only on behalf of myself.

The class-action procedure is one of many ways consumers can vindicate their rights, but, all too often, class actions are abused to benefit attorneys at the expense of the consumers they purport to represent, a wealth transfer from the 99 percent to the 1 percent.

In the class-action settlement process, the class counsel is trying to maximize their profits while the defendant is trying to minimize the expense of the litigation and the settlement. But when courts fail to follow the Federal rules and the Class Action Fairness Act requirements of scrutinizing the fairness of a settlement, the parties all too often tacitly agree to freeze out the absent party at the table—the consumer class members that the settlement is supposed to be benefiting.

Cy pres distributions, which are money given to third-party charities instead of to the class, are one of the leading ways to abuse the settlement process to create the illusion of class recovery while diverting the true bulk of the settlement to the attorneys.

When plaintiffs' attorneys are paid based on the size of funds rather than based upon what the class actually recovers, they have a perverse incentive to make it harder for their own clients to get access to justice and recover.

In the Third Circuit case I argued and won last month, the District Court did not even try to make findings to learn about whether class members would benefit, and rubberstamped a $14 million attorney payment. It took the appellate court scrutiny to determine that because the claims process required a burdensome five-page claim reform to request recovery as low as $5, less than $3 million would have gone to the class, less than a fifth of what the attorneys were going to receive.

The attorneys were perfectly happy with this because they were being paid based on the size of the total settlement fund, and they would have gotten to steer $17 million to their favorite charity in addition to their $14 million fee.

So, all too often, the cy pres is a way for the attorneys to double dip. Money goes to the attorney's alma mater or, in one case, a charity run by the ex-wife of the class counsel.

Now, while the Third Circuit in my baby products case asked for more scrutiny of such settlements, other courts have been more lenient. In the case of *Lane v. Facebook*, the Ninth Circuit, in a 2-to-1 opinion, affirmed the settlement approved by the District Court, where $3.2 million went to the attorneys, zero dollars to the class, and Facebook's only other burden was to create a new charity run by Facebook and give it $6 million.

So that is like a settlement against Microsoft settling for Microsoft giving money to the Gates Foundation.

In effect, the class got zero dollars, the attorneys got $3.2 million, and the defendant got a waiver of whatever claims were against it.

Worse still are the cases where a judge treats cy pres as his or her own plaything. In the Google Plus class-action settlement—again, a zero dollar class-action settlement for the class where the only money was going to charity—Judge Ware, without notice to the class, decided that a substantial part of the cy pres be diverted to a local university where he teaches.

Again, the class got zero dollars. The attorneys got millions. Google got to give money to charities that, in large part, it was giving to anyway.

In many cases, sunlight or transparency is a great disinfectant to this problem. For example, in the Apple backdating settlement, where one of my clients objected, the parties planned to divert $2.5 million from shareholders to a dozen schools, some of whom were affiliated with class counsel, where the class counsel sat on the board. When I blew the whistle, the parties quickly amended the settlement so that the money went to the class, to the supposedly injured shareholders, rather than to the friends of the class counsel.

In the Bayer aspirin case currently pending in Federal District Court in Brooklyn, I objected that the attorneys planned to pay $5 million to themselves, $8 million to charities affiliated with the class counsel, and less than $100,000 to the class. In response to the scrutiny and to press coverage of my objection, the parties suddenly discovered that, yes, they did have a list of class members to whom they could pay $5 million.

But the cases I mentioned are just the tip of the iceberg. The center has limited resources and cannot possibly object to every bad settlement. And when we do not object, and sometimes even when we do, these bad settlements are rubberstamped.

Attorneys and judges face no consequences for failing to disclose their conflicts of interest to the court or to the class, and so there are certainly many more egregious cases of self-dealing than we know about.

If courts fail to act here, there is a role for Congress to protect consumers from this class-action abuse.

I welcome your questions.

[The prepared statement of Mr. Frank follows:]

Statement before the House Judiciary Committee
Subcommittee on the Constitution and Civil Justice
Examination of Litigation Abuse

Cy Pres Settlements

Theodore H. Frank

Adjunct Fellow – Manhattan Institute Center for Legal Policy

President – Center for Class Action Fairness

March 13, 2013

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the Manhattan Institute or the Center for Class Action Fairness.

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Thank you, Mr. Chairman, and members of this Subcommittee, for your kind invitation to testify today about abusive *cy pres* settlements.

I serve as an Adjunct Fellow at the Manhattan Institute Center for Legal Policy and as President for the Center for Class Action Fairness,[1] but I am not testifying here on their behalf and the views that I am sharing today are my own. My perspective comes from my legal practice running a non-profit public-interest law firm focusing on litigation in class actions on behalf of class members in cases where their court-appointed attorneys have failed to fairly represent their clients' interests. I was elected to the American Law Institute in 2008, and have published and spoken across the country on topics related to class actions.[2]

Background: Class Action Settlements

Class actions were designed to provide injured parties with a more efficient means of accessing justice by aggregating claims for violations of individual rights.[3] Although most successful class action litigation under Rule 23 is resolved in the form of

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[1] I founded the Center for Class Action Fairness in 2009. The Center is a 501(c)(3) public-interest law firm that represents *pro bono* consumers and shareholders objecting to unfair class action settlements that benefit class counsel at the expense of their putative clients. Attorneys with the Center have won several landmark cases expanding the rights of consumers in class action settlements. *E.g.*, *In re Baby Products Antitrust Litigation*, No. 12-1165 (3d Cir. Feb. 19, 2013); *In re Bluetooth Prod. Liab. Lit.*, 654 F.3d 935 (9th Cir. 2011); *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2011); *Robert F. Booth Trust v. Crowley*, 687 F.3d 314 (7th Cir. 2012); *Dewey v. Volkswagen AG*, 681 F.3d 170 (3d Cir. 2012).

[2] Portions of this testimony are drawn from Ted Frank, *Class Actions, Arbitration, and Consumer Rights*, Legal Policy Report No. 16 (Manhattan Institute 2013); *and* Theodore H. Frank, *Cy Pres Settlements*, Class Action Watch (Mar. 2008).

[3] *See* Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. Chi. Legal F. 71, 77 (2003).

a class settlement, such class settlements frequently provide little or no meaningful compensation to consumers. Indeed, a significant number of consumer class settlements do not provide consumers with any monetary relief whatsoever. This systematic under-compensation is the product of two structural problems in class actions. First, because class attorneys' fees generally come from the same source as the class members' compensation—the defendant—class attorneys settling class claims have a fundamental conflict of interest.[4] Second, to the extent class attorneys exploit that conflict of interest, judges lack the necessary information or incentive to rectify self-dealing in most cases.

The principal reason for the failure of many class settlements to provide meaningful compensation is obvious: class attorneys have incentives to engage in self-dealing during the negotiation of class settlements.[5] Because class members, especially those in a small-claims consumer class action, have small stakes in the case and therefore usually do not closely monitor their attorneys' conduct, class attorneys often are able to obtain high fees without obtaining meaningful compensation for class members.[6]

Indeed, all three branches of government have recognized this economic reality. In enacting the Class Action Fairness Act of 2005,[7] Congress found that "[c]lass members often receive little or no benefit from class actions, and are sometimes harmed,

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[4] *E.g., Mirfasihi v. Fleet Mortgage Corp.*, 356 F.3d 781, 785 (7th Cir. 2004).

[5] *See, e.g.*, Ted Frank, *Class Actions, Arbitration, and Consumer Rights*, Legal Policy Report No. 16 at 6-11 (Manhattan Institute 2013); Lester Brickman, *Lawyer Barons* 335-72 (Cambridge U. Press 2011); John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 Colum. L. Rev. 1343, 1347-48 (1995); Coffee, 54 U. Chi. L. Rev. at 883-84; Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 7-8 (1991).

[6] In a now-classic study, Andrew Rosenfeld demonstrated that a class attorney that settles a class action enjoys a "settlement premium" above the average attorney's fee awarded in a class action that proceeds to judgment. *See An Empirical Test of Class-Action Settlement*, 5 J. Legal Stud. 113, 115-17 (1976). This premium is consistent with the hypothesis that class attorneys will maximize their fees at the expense of the class members' compensation. *See also, e.g.*, Frank, *Class Actions* 6-11; Coffee, 54 U. Chi. L. Rev. at 883-84.

[7] CAFA, Pub. L. No. 109-2, § 2, 119 Stat. 4.

such as where . . . counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value."[8]

Similarly the FTC has recognized that "[e]xcessive class action attorney fee awards represent a substantial source of consumer harm."[9]

Courts also have recognized the harm to consumer welfare caused by the class attorney's conflict of interest: "the negotiator on the plaintiffs' side, that is, the lawyer for the class, is potentially an unreliable agent of his principals" given the possibility that he may trade a small class award for the relatively certainty of a high fee award.[10]

One of the leading ways for self-dealing class counsel to benefit themselves at the expense of the class is through what are called *cy pres* settlements.

The Problem of *Cy Pres* Relief.[11]

The idea of *cy pres* (pronounced "see pray" or "sigh pray," from the French *cy pres comme possible*—"as near as possible") originated in the trust context, where courts would reinterpret the terms of a charitable trust when literal application of those terms

[8] *See id.* at 4; *see also* S. Rep. No. 109-4, at 33.

[9] R. Ted Cruz, Dir. Office of Policy Planning, FTC, Friend of the Court: The Federal Trade Commission's Amicus Program, Remarks Before the Antitrust Section of the American Bar Association 13 (Dec. 12, 2002) ("Not infrequently, the interests of a private class action attorney may substantially diverge from the interests of the class."), *available at* http://ftc.gov.speeches/other/tcamicus; Deborah Platt Majoras, Chairwoman, FTC, *Comments at the FTC Workshop: Protecting Consumer Interests in Class Actions* (Sept. 13, 2004), *in* 18 Geo. J. Legal Ethics 1161, 1162-63 (2005) (class actions may not "truly serve consumers' interests by providing them appropriate benefits"; encouraging "consumers to carefully scrutinize opt-out notices and class action settlement terms and particularly attorney fee awards that may reduce the total compensation available to consumers").

[10] *Mars Steel Corp. v. Continental Ill. Nat'l Bank & Trust Co.*, 834 F.2d 677, 681-82 (7th Cir. 1987).

[11] For more on *cy pres*, *see* Frank, *Class Actions* 8-9; Martin Redish *et al.*, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617 (2010); John H. Beisner *et al.*, *Cy Pres: A Not So Charitable Contribution to Class Action Practice* (2010); Theodore H. Frank, *Cy Pres Settlements*, Class Action Watch (Mar. 2008).

resulted in the dissolution of the trust because of impossibility or illegality.[12] In a classic 19th-century example, a court repurposed a trust that had been created to abolish slavery in the United States to instead provide charity to poor African-Americans.[13] The California Supreme Court endorsed the use of *cy pres* or "fluid recovery" mechanism in class action settlements in 1986, to distribute proceeds to a "next best" class of consumers, and many other courts have gradually adopted the procedure.[14] *Cy pres* settlements arise in one of three circumstances:

- There is a fixed settlement fund that exceeds the amount paid out because only a few class members have registered to be claimants;
- The court (often at the parties' behest) decides that administering a settlement by paying class members directly would be too expensive;
- The parties otherwise agree that a case shall be settled by paying a third party.

While original *cy pres* class action settlements provided that left-over money be distributed to a different set of consumers who may or may not coincide with the class, in recent years, left-over, or specifically earmarked, funds are typically given directly to a third-party charity.

The problem with *cy pres* is that it exacerbates existing conflicts of interest in the class action settlement context. When a class attorney settles a class action, he or she is not only negotiating class recovery, but is also negotiating his or her own fee. A defendant may be willing to spend a certain amount of money to settle a class action to avoid the expense and risk of litigation, but that money must be divided between the

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[12] Susan Beth Farmer, *More Lessons From the Laboratories: Cy Pres Distributions in Parens Patriae Antitrust Actions Brought by State Attorneys General*, 68 FORDHAM L. REV. 361, 391-93 (1999); RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 509-10 (4th ed. 1992); BRYAN A. GARNER, BLACK'S LAW DICTIONARY 392 (7th ed. 1999). "Justification for the use of the doctrine [in the middle ages] was laid on the shoulders of the donor, the idea being since the object of the testator in donating the money to charity was to obtain an advantageous position in the kingdom of heaven, he ought not to be frustrated in this desire because of an unexpected or unforeseen failure." *Id.* (quoting EDITH L. FISCH, THE CY PRES DOCTRINE IN THE UNITED STATES 4 (1950)).

[13] *Jackson v. Phillips*, 96 Mass. 539 (1867). *But see* Evans v. Abney, 396 U.S. 435 (1970) (upholding Georgia Supreme Court's dissolution of trust providing for segregated municipal park).

[14] *State v. Levi Strauss & Co.*, 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (1986).

class and their attorneys. Every dollar going to the attorneys does not go to the class, and vice versa. At the same time, a class action settlement must be approved by the court. Attorneys who do not adhere to their fiduciary responsibility to the class have an incentive to exaggerate class recovery to a court to maximize their fees.

The possibility of *cy pres* awards gives an additional incentive to class action attorneys to breach their fiduciary duties to the class. Every dollar that a class member does not recover can now be spent by the attorney himself to the charity of the attorney's choice. Attorneys essentially get free advertising: witness the existence of websites like "ohiolawyersgiveback.com" where lawyers are using their clients' money to advertise themselves. At best this is unseemly; at worst, it is an unethical breach of the attorneys' fiduciary duty to put the interests of their clients first. If courts permit unfettered *cy pres*, then attorneys have an incentive to make it difficult for their own putative clients to recover, because then they can maximize the amount of money that goes to charity in the attorneys' names. This hurts class members. For example, in a settlement I successfully challenged in the Third Circuit,[15] the parties created substantial burdens, including a five-page claim form with confusing instructions, that successfully deterred class members from making claims on the settlement fund. If my client had not successfully appealed the settlement approval, class members would have received less than $3 million, while the class counsel would have received about $15 million to distribute to its favorite charity, plus another $14 million for itself.

Judge Richard Posner has argued that *cy pres* is a misnomer in the class action context:

> [*Cy pres*] doctrine is based on the idea that the settlor would have preferred a modest alteration in the terms of the trust to having the corpus revert to his residuary legatees. So there is an indirect benefit to the settlor. In the class action context the reason for appealing to cy pres is to prevent the defendant from walking away from the litigation scot-free because of the infeasibility of distributing the proceeds of the settlement (or the judgment, in the rare case in which a class action goes to judgment) to the class members. There is no indirect benefit to the class from the defendant's giving the money to someone else. In such a case the "cy pres" remedy (badly misnamed, but the alternative term—"fluid recovery"—is no less misleading) is purely punitive.[16]

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[15] *Baby Products, supra.*

[16] *Mirfahisi v. Fleet Mortgage Corp.*, 356 F.3d 781, 784 (7th Cir. 2004).

But sometimes *cy pres* is less a matter of being punitive and more a matter of disguising the true cost of a settlement to the defendant to maximize the share of the actual recovery received by the plaintiffs' attorneys. If the beneficiary is related to the defendant, or the defendant otherwise benefits from the payout, then the contingent attorneys' fee can be exaggerated by claiming that the value to the class is equal to nominal value of the payment to the beneficiary; the defendant is willing to make a larger nominal contribution to settle the case than the actual cost to the defendant. For example, a California state court settlement of a derivative action against Larry Ellison alleging insider trading settled when Ellison agreed to pay $100 million to a charity chosen by Oracle—even though the billionaire has previously stated that his fortune would go to charity.[17] The only real expense to Ellison was the $22 million attorneys' fee. More recently, Facebook settled a suit by establishing a charity run by a Facebook board member, and funding it with $6.5 million dollars; again, the class did not benefit, and the only expense to Facebook was the $3.2 million fee paid to the class attorneys. If the charitable contribution is one that the defendant was making anyway, the effect on the defendant is one of a change of accounting entries rather than any cost to the defendant or benefit to the class aside from the attorneys' fees.[18] While federal courts are starting to crack down on such abuses, they are doing so inconsistently, and parties are still trying to get away with such shenanigans.[19]

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[17] Ted Frank, "Final update: Oracle settlement," Point of Law weblog, http://www.pointoflaw.com/archives/001875.php (Nov. 23, 2005) ("That the plaintiffs are settling for pennies on the dollar with no benefit to the corporation on whose behalf they're ostensibly suing, as well as the fact that a Delaware court has already absolved Ellison of the same charges, suggests that even the plaintiffs recognize the suit as meritless."); Michael Paige, "Judge OKs Ellison's $122M settlement," MarketWatch, Nov. 22, 2005; Peter Branton, "Wealth of Experience," IT Weekly (Jul. 9, 2006) ("I think after a certain amount, I'm going to give almost everything I have to charity because what else can you do with it?").

[18] For example, Kellogg agreed to class action settlements that required it to donate a few million dollars of products to food-banks—something it was already doing to the tune of tens of millions of dollars a year. *Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012) (rejecting settlement).

[19] *Compare Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012); *Nachshin v. AOL LLC*, 663 F.3d 1034 (9th Cir. 2011); *and Klier v. Elf Atochem N. Am.*, Inc., 658 F.3d 468 (5th Cir. 2011); *with Lane v. Facebook*, 696 F.3d 811 (9th Cir. 2012). In *Lane*, the *cy pres* went to a new charity established by defendant Facebook, who could then direct the money to

Further ethical problems arise if the beneficiary is related to the judge. The *New York Times* has documented the problem of charities soliciting judges for leftover settlement money.[20] In one notorious case, a judge directed *cy pres* to an animal-rights group in a class action over a hotel fire.[21] In a mass-tort inventory settlement of fen-phen cases in Kentucky, tens of millions of dollars intended for plaintiffs was diverted to a newly created charity, where the judge who approved the settlement and three of the plaintiffs' attorneys sat as board members, each receiving tens of thousands of dollars for their service. The settlement also provided a million dollars to the alma mater of one of the trial lawyers, which then hired the attorney for a $100,000/year no-show job. (Two of the attorneys were eventually convicted, and too few people went to prison over this.)[22]

While this is obviously an extreme case, it does illustrate the ethical problems associated with judges choosing or approving charitable destinations for settlement money. In a settlement I objected to, the parties in a nationwide class action proposed a *cy pres* award to a local charity where the judge's husband served as a board member; the judge rubber-stamped the proposed settlement over an objection regarding the appropriateness of the *cy pres* award.[23] The Ninth Circuit reversed on other grounds, but refused to condemn the conflict of interest.[24] This appearance of impropriety damages public perceptions of the fairness of the justice system, and appellate courts should be doing more to police it.

More frequently, if the beneficiary is related to the plaintiffs' attorneys, or the plaintiffs' attorneys otherwise benefit from the payout, the award rewards trial lawyers

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recipients favorable to Facebook's lobbying interests, a tactic that is being repeated by Facebook in the pending *Fraley v. Facebook* settlement. Roger Parloff, *Google and Facebook's new tactic in the tech wars*, CNN MONEY (Jul. 30, 2012), available at http://tech.fortune.cnn.com/2012/07/30/google-and-facebooks-new-tactic-in-the-tech-wars/.

[20] Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES (Nov. 26, 2007).

[21] *In re San Juan Dupont Plaza Hotel Fire Litigation*, 2010 WL 60955 (D. P.R. Jan. 7, 2010).

[22] Ted Frank, "Fen-Phen Zen," American.com (Apr. 4, 2007).

[23] Nathan Koppel, *Proposed Facebook Settlement Comes Under Fire*, WALL STREET JOURNAL (Mar. 2, 2010).

[24] *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2011).

twice: first by providing *cy pres* recovery to an organization that supports the agenda or causes of the trial lawyers bringing the case, and then a second time by basing attorneys' fees on the first amount.

In July 2007, a district court judge granted a motion to award $5.1 million of unclaimed antitrust settlement funds to George Washington University to create a "Center for Competition Law" on the grounds that it would "benefit the plaintiff class and similarly situated parties by creating a Center that will help protect them from future antitrust violations and violations of other competition laws."[25] The lead plaintiffs' attorney was a GWU Law alumnus.[26] I represent a client appealing an approval of a settlement of a class action with a national class where over $2 million of *cy pres* is going to three San Diego universities (including the *alma mater* of class counsel), class counsel is being paid $8.85 million, but the class will receive only about $225,000 in cash.[27] In another settlement where class counsel was already scheduled to receive $27 million, *cy pres* was designated to a charity run by the ex-wife of class counsel.[28] Such problems go beyond trial lawyers and civil lawsuits; Richard Epstein has criticized a Bush administration settlement with Bristol-Myers Squibb requiring them to endow a chair of ethics at the District of New Jersey U.S. Attorney's *alma mater*, Seton Hall Law School.[29]

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[25] Diamond Chemical Co. v. Akzo Nobel Chemicals B.V., No. 01-2118 (May 14, 2007) ("Diamond I"); Diamond Chemical Co. v. Akzo Nobel Chemicals B.V., No. 01-2118 (Jul. 10, 2007); George Washington University press release, July 11, 2007.

[26] Ashley Roberts, *Law School Gets $5.1 Million to Fund New Center*, GW Hatchet (Dec. 3, 2007).

[27] *In re EasySaver Rewards Litigation*, No. 13-55373 (9th Cir.). I have previously successfully blocked a diversion of $2.5 million of a settlement fund to third-party charities (including two schools affiliated with class counsel). Alison Frankel, "Legal Activist Ted Frank Cries Conflict of Interest, Forces O'Melveny and Grant & Eisenhofer to Modify Apple Securities Class Action Deal," *American Lawyer Litigation Daily* (Nov. 30, 2010).

[28] *In re: Chase Bank USA NA "Check Loan" Contract Litigation*, No. 09-md-02032 (N.D. Cal.). The conflict of interest was not disclosed to the district court, which approved the settlement.

[29] Richard A. Epstein, *The Deferred Prosecution Racket*, WALL ST. J. (Nov. 28, 2006).

Certainly, the desire to give money to charity is a good cause. But there are surely more efficient ways to do so than to give *carte blanche* to plaintiffs' attorneys to direct class members' money and then have them take a 25 to 40 percent commission on the donation. In practice, *cy pres* "creates the illusion of class compensation" without actually compensating the class.[30] And as Judge Edith Jones has said, "district courts should avoid the legal complications that assuredly arise when judges award surplus settlement funds to charities and civic organizations."[31]

There are several possible responses to the issue of unfettered *cy pres* awards, which frequently have too little scrutiny from courts, despite the clear conflicts of interest they present between class members and their attorneys. The American Law Institute's Principles of the Law of Aggregate Litigation proposes limiting *cy pres* to "circumstances in which direct distribution to individual class members is not economically feasible, or where funds remain after class members are given a full opportunity to make a claim."[32] This would imply that a settlement distribution should go to class members who have filed a claim, although some courts have rejected such a solution as a windfall to class members, especially when the number of class members filing claims is small relative to the size of the class.[33] Another possibility is already contemplated by federal law: unclaimed funds escheat to the treasury.

There is still another possible solution. The federal Class Action Fairness Act bases fee awards in coupon settlements on the actual redeemed value of the coupons; if coupons are donated to charity, those coupons cannot be used to calculate a fee award.[34] The same principle should apply when cash is involved; at a minimum, money given to *cy pres* should not count dollar for dollar like money given to class members. Contingent-fee attorneys should be rewarded only for benefits going directly to the class. Moreover, if a *cy pres* settlement benefits the attorneys directly or indirectly, that settlement should offset the attorneys' fees. A $1 million *cy pres* award on behalf of a charity related to class counsel should count as part of the attorneys' fee award, not as a

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[30] Redish, 62 Fla. L. Rev. at 623.

[31] *Klier v. Elf Atochem*, 653 F.3d 468, 481-82 (5th Cir. 2011) (Jones, J., concurring).

[32] § 3.08. *See also Klier, supra*; *Masters v. Wilhelmina Model Agency, Inc.*, 473 F.3d 423 (2d Cir. Jan. 4, 2007); Liptak, *supra* n. 12. *But see Baby Products, supra* (suggesting mechanism as possibility, but refusing to require district courts to do this).

[33] *Fears v. Wilhelmina Model Agency, Inc.*, No. 02 Civ 4911 (S.D.N.Y. Jul. 5, 2007).

[34] 28 U.S.C. § 1712(e).

justification for additional attorneys' fees. Such a mechanism would give plaintiffs' attorneys the proper incentive to align their interests with those of the class when devising a settlement: if the settlement does not benefit class members, the attorneys should not be realizing disproportionate benefit. Judge Lee Rosenthal correctly recognized the need to structure incentives *ex ante*, and discounts *cy pres* in calculating settlement benefit; this should be standard practice, rather than a rare exception.[35]

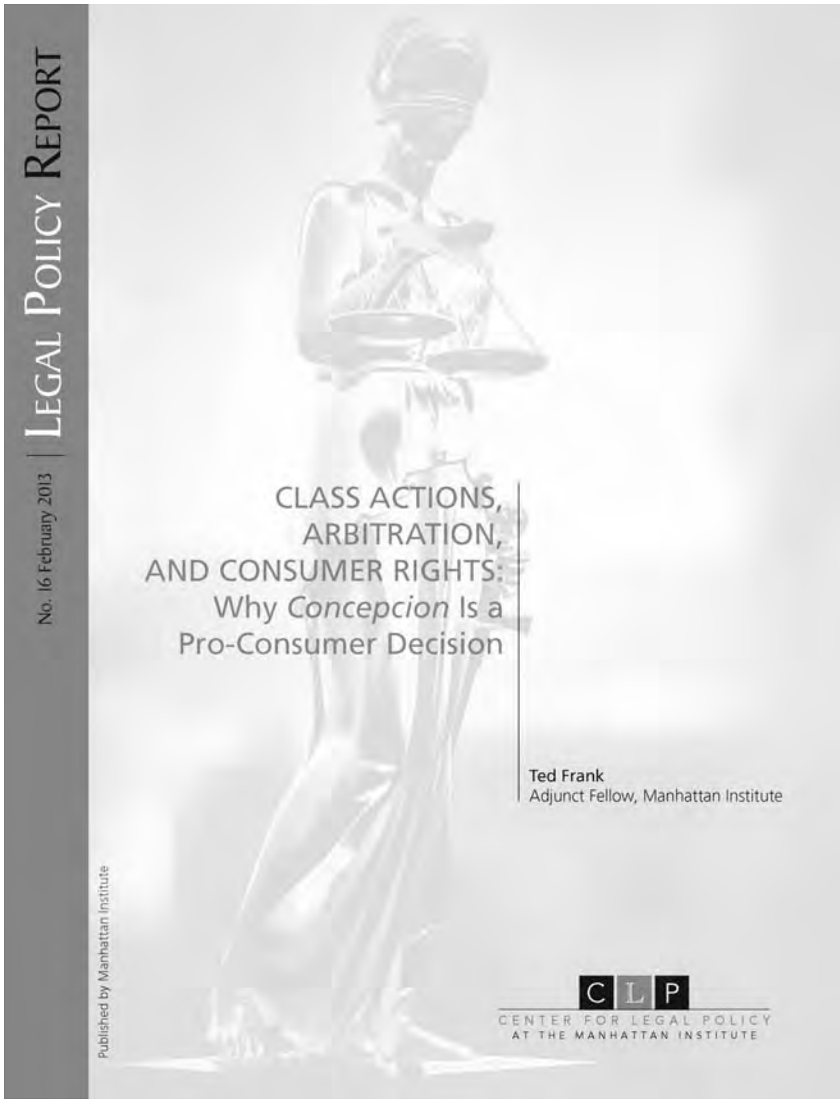
At a minimum, the parties should be required to give notice to the class of who the *cy pres* recipients are, and whether there are relationships between the recipients and the parties, attorneys, and judge. Though this information is plainly material to the fairness of a settlement, courts have generally refused to establish bright-line rules that penalize parties that hide this information from class members.[36]

I welcome your questions.

[35] *In re Heartland Payment Sys.*, 851 F. Supp. 2d 1040, 1076-77 (S.D. Tex. 2012).

[36] *Baby Products*, *supra*; *Nachshin*, *supra*.

ATTACHMENT



LEGAL POLICY REPORT

No. 16 February 2013

CLASS ACTIONS, ARBITRATION, AND CONSUMER RIGHTS: Why *Concepcion* Is a Pro-Consumer Decision

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C L P
CENTER FOR LEGAL POLICY
AT THE MANHATTAN INSTITUTE

Published by Manhattan Institute

On February 27, 2013, the Supreme Court will hold oral arguments in *American Express Co. v. Italian Colors Restaurant*. Like the Court's 2011 decision in *AT&T Mobility v. Concepcion*, *Italian Colors* involves the intersection of two mechanisms for resolving legal disputes not easily handled by high-cost individually filed lawsuits: arbitration and class action litigation.

In class action litigation, similarly situated legal claims are aggregated under a single lawsuit. Given the cost of litigation, class action suits can be efficient mechanisms for resolving large numbers of relatively low-dollar claims, but they also can enrich lawyers at legitimate claimants' expense because such lawsuits' low value to individual plaintiffs reduces the incentive for any plaintiff to monitor the lawyers handling the claim.

Arbitration, a form of dispute resolution outside the courts, involves imposing as legally binding and enforceable the decision of a third party, typically specified in advance in contracts. Arbitration is generally favored and enforceable under federal law, through the 1925 Federal Arbitration Act (FAA). Potential corporate defendants have sought to use mandatory arbitration clauses to avoid the expense of class actions. The trial bar and allies in the legal academy criticized such clauses as "anticonsumer" and, for years, had success, particularly in California state court, in obtaining judicial rulings finding the clauses unenforceable, notwithstanding the language of the FAA.

Concepcion

Concepcion concerned AT&T's cell phone contracts, which included a mandatory arbitration clause that prohibited customers from bringing class action lawsuits against the carrier. Applying California law, the Ninth Circuit ruled that these clauses were "unconscionable" and thus unenforceable under state law—even though the court acknowledged that the arbitration clauses provided an adequate remedy to individual consumers. The Supreme Court reversed, determining that California's unconscionability rule as applied to AT&T's contract conflicted with the FAA, which preempted the conflicting state law. In reaching its holding, the Court determined that the California rule frustrated the FAA's objective of making arbitration agreements enforceable in national commerce and that AT&T's mandatory arbitration clause was "fundamentally fair" under the FAA.

Italian Colors

Italian Colors concerns an arbitration provision in the card-acceptance agreement that American Express enters into with retail businesses that agree to offer customers the option of using the company's charge or credit cards. The *Italian Colors* plaintiffs allege that AmEx's requirement that vendors accept both its charge and credit cards to do business with the company is a "tying arrangement" in violation of federal antitrust law. In February 2012, the Second Circuit held that the arbitration provision in AmEx's card-acceptance agreement was unenforceable against plaintiffs' claim, given that the high costs associated with pursuing an antitrust claim would preclude the "effective vindication of rights" absent a classwide treatment. On November 9, the Supreme Court granted *certiorari*.

Some commentators have argued that the Court's decision in *Concepcion* is likely to erode consumer rights—or even lead to the death of all class action lawsuits against businesses. These critics claim that mandatory arbitration agreements bar consumers from enjoying protections that only class actions can guarantee. These concerns are overwrought.

I. As a general matter, consumers are likely to benefit from the ability to opt for individual arbitration in lieu of class actions.

Class action lawsuits are a means of consumer protection—not the ends.

A. Class actions suffer from several structural deficiencies that can prevent class members from having their rights vindicated. Class actions often take years to reach a settlement, and even when they do, the parties have the incentive to structure settlement terms to make it difficult for class members to obtain substantive relief. Moreover, the large expense of class action defense means that, in the absence of procedural protections against self-dealing settlements, trial lawyers have the incentive to bring class actions of low merit. Thus, the deterrent effect of class actions is small because the innocent are treated by the judicial system little better than the guilty.

B. Compared with class actions, individual arbitration is notably efficient and effective at protecting consumer rights. Instead of taking years, the average consumer arbitration lasts just short of seven months. Also, despite claims to the contrary, consumers achieve equal or greater recoveries in arbitration compared with class actions. Consumers, unsurprisingly, prefer arbitration over litigation.

C. Companies' savings from arbitration are passed on to the consumer in the form of lower prices. Although consumers who prefer committing to mandatory arbitration to avoid paying higher prices can do so under *Concepcion*; those who do not are effectively protected by market mechanisms. Companies have an incentive to offer effective complaint-resolution processes to foster brand image and loyalty, which result in increased demand for goods and services.

II. Though the Second Circuit's decision in *Italian Colors* is incorrect and should be reversed, class action lawsuits against businesses will not cease in the wake of *Concepcion* or a reversal in *Italian Colors*.

In particular, class actions will continue largely unabated in the areas of contractual employment disputes and securities litigation. Many consumer class actions can be expected to continue as well, given the significant transaction costs that companies face in developing arbitration clauses that are enforceable under *Concepcion*.

Overall, the Supreme Court's decision in *Concepcion* has not led, and should not be expected to lead, to a broad erosion of consumer rights, as some alarmists have predicted. Unless the Court broadens its *Concepcion* holding in *Italian Colors*, beyond what the petitioners have asked for, many forms of class action lawsuits will continue, and those that are replaced by individual arbitration will generally lead to greater consumer protection, not less. *Concepcion* is appropriately viewed as an endorsement of a consumer's right to choose, not as a death knell for class action lawsuits and consumer rights.

About the Author

TED FRANK is an adjunct fellow with the Manhattan Institute's Center for Legal Policy and editor of the Institute's award-winning web magazine, PointofLaw.com. *The Wall Street Journal* has called him a "leading tort-reform advocate." Frank is also the president of the Center for Class Action Fairness, which he founded in 2009. He has written for law reviews, *The Wall Street Journal*, the *Washington Post*, and *The American Spectator*, and has testified about legal issues before Congress. He serves on the executive committee of the Federalist Society Litigation Practice Group. In 2008, Frank was elected to membership in the American Law Institute. Previously, Frank clerked for Frank H. Easterbrook on the United States Court of Appeals for the Seventh Circuit, was a litigator in private practice for 10 years, served as the first director of the AEI Legal Center for the Public Interest, and was an attorney for the McCain-Palin 2008 presidential campaign. Frank graduated from the University of Chicago Law School with high honors and as a member of the Order of the Coif and the Law Review.

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Class Actions, Arbitration, and Consumer Rights: Why Concepcion Is a Pro-Consumer Decision

Ted Frank

I. INTRODUCTION

On February 27, 2013, the Supreme Court will hold oral arguments in *American Express Co. v. Italian Colors Restaurant*,[1] an appeal from a decision by the U.S. Court of Appeals for the Second Circuit that invalidated a mandatory arbitration provision under federal law. *Italian Colors* follows on the heels of the 2011 5–4 Supreme Court decision in *AT&T Mobility LLC v. Concepcion*[2] striking down the Ninth Circuit's use of California state law to invalidate a mandatory arbitration provision. The *Concepcion* decision has generated a lot of hand-wringing in certain circles, with numerous scholars and activists complaining that the Court's ruling would result in untold harm to consumers and even in the "death" of the class action itself; these complaints are usually matched with calls for congressional legislation.[3] While a full assessment of the Supreme Court's class action jurisprudence should await its decision in *Italian Colors*, the scholars' and activists' complaints about *Concepcion* are generally overstated. Competitive market pressures generally ensure that consumers are unambiguously better off by being given the option to pre-commit to mandatory arbitration. And if the Court in *Italian Colors* adheres to the general principles it embraced in *Concepcion*, there will still be plenty of class actions, and perhaps too many at the margin.

I. BACKGROUND

Arbitration and class actions

Arbitration and class action litigation are each mechanisms for resolving legal disputes not easily handled by high-cost individually filed lawsuits. Arbitration, a form of dispute resolution outside the courts, involves imposing as legally binding and enforceable the decision of a third party, under rules and procedures agreed to in advance by the contracting parties. Arbitration is generally favored and enforceable under federal law, through the 1925 Federal Arbitration Act (FAA).[4]

In class action litigation, plaintiffs are permitted to aggregate similarly situated legal claims under a single lawsuit. Class action lawsuits for monetary damages trace to the 1938 adoption of the Federal Rules of Civil Procedure,[5] though the modern practice of adding plaintiffs to the class unless they affirmatively opt out of the litigation originated in 1966 amendments to those rules.[6] Arbitration agreements can, but need not, include class action–type mechanisms for aggregating multiple common claims.[7]

In recent years, the Supreme Court has issued two major decisions clarifying the extent to which arbitration agreements can preclude class action remedies. In its 2010 decision in *Stolt-Nielsen* v. *Animal Feeds International*,[8] the Court held that under the FAA, arbitrators cannot force classwide arbitration upon parties that did not agree to these procedures in the arbitration provisions of their contracts. In the following year, in *Concepcion*, the Court held that California courts' determination that state law rendered arbitration agreements that precluded class action remedies unenforceable was preempted by the FAA.

The Trial Bar's Anti-Arbitration Campaign

The Supreme Court's decisions follow in the wake of an anti-arbitration campaign by the plaintiffs' bar involving public relations and litigation and seeking legislation and regulation.[9] Arbitration clauses present a challenge to the business model of the class action plaintiffs' bar because when consumers are given a choice between contracting for a lower-priced product or service with a mandatory arbitration clause and paying a higher price to avoid a pre-commitment to arbitration, they almost invariably choose the benefits of mandatory arbitration.[10] Because the streamlined arbitration process is cheaper than litigation and presents less dramatic outliers in rulings, businesses have a strong incentive to adopt arbitration clauses. (Indeed, ironically, trial lawyers—including Concepcion's own attorney—regularly use mandatory arbitration clauses in their own retainer agreements, with no consumer group complaining about the practice.)[11]

Notwithstanding the Supreme Court's holdings in *Stolt-Nielsen* and *Concepcion*, the trial bar's anti-arbitration campaign has met with partial success. A one-sided and misleading Public Citizen report criticizing arbitration[12] was adopted wholesale by many media outlets.[13] Though the most far-reaching federal legislative efforts to undo the FAA failed, a bill passed that eliminated arbitration in the context of military personnel.[14] Moreover, the Dodd-Frank Act created the Consumer Financial Protection Bureau (CFPB), and expressly tasked it with regulating the use of mandatory arbitration clauses in financial contracts; given the over-paternalistic instincts of the lawyers in charge of the agency,[15] it will be little surprise if the regulators running the organization choose to ban such clauses in their bailiwick.

The Path to Concepcion

On the litigation side, the trial bar found success in California, where state courts used "unconscionability" doctrine to strike down mandatory arbitration clauses.[16] Businesses that used mandatory arbitration clauses found them of no protection once they were hauled into California state court or into federal courts applying California state law.[17] Trial lawyers could "forum shop" national class actions in courts willing to disregard arbitration provisions.[18]

In that context, AT&T Mobility, in conjunction with its attorneys at Mayer Brown, devised a legal strategy to challenge the California decisions: construct an arbitration clause so plainly friendly and fair to consumers that any finding of the clause being "unconscionable" must be motivated by discrimination against arbitration, rather than a desire to protect substantive and procedural consumer rights. Because such discrimination would run afoul of the FAA's requirement that arbitration clauses be placed "on an equal footing with other contracts,"[19] federal law would preempt the application of state-court law to the contrary. And the AT&T Mobility contract was extraordinarily generous:

> The revised agreement provides that customers may initiate dispute proceedings by completing a one-page Notice of Dispute form available on AT&T's website. AT&T may then offer to settle the claim; if it does not, or if the dispute is not resolved within 30 days, the customer may invoke arbitration by filing a separate Demand for Arbitration, also available on AT&T's website. In the event the parties proceed to arbitration, the agreement specifies that AT&T must pay all costs for nonfrivolous claims; that arbitration must take place in the county in which the customer is billed; that, for claims of $10,000 or less, the customer may choose whether the arbitration proceeds in person, by telephone, or based only on submissions; that either party may bring a claim in small claims court in lieu of arbitration; and that the arbitrator may award any form of individual relief, including injunctions and presumably punitive damages. The agreement, moreover, denies AT&T any ability to seek reimbursement of its attorney's fees, and, in the event that a customer receives an arbitration award greater than AT&T's last written settlement offer, requires AT&T to pay a $7,500 minimum recovery and twice the amount of the claimant's attorney's fees.[20]

No reasonable person could deem such a clause an artifice to render a corporate defendant immune from individual claims. And the trial court indeed made a factual finding that the clause permitted the vindication of individual claims. Nevertheless, the Ninth Circuit refused to enforce the arbitration clause, holding that its waiver of class action rights, even class action arbitration rights, made it unenforceable under California law.[21] Thus, while the Ninth Circuit acknowledged that the arbitration provision "essentially guarantee[d]" that AT&T would make whole every customer who complained, the fact that not every customer would complain made the provision unenforceable because absent class members would not have their rights vindicated.[22]

The Supreme Court reversed on a 5–4 vote, with justices Ginsburg, Breyer, Sotomayor, and Kagan dissenting.[23] The plaintiffs having conceded that California could not generate rules aimed at destroying arbitration or demand procedures incompatible with arbitration,[24] only a very small step of logic was required for the majority to determine that a court could not use judicially created doctrines against arbitration to effect what the state legislature could not.[25] As there was no dispute that the AT&T Mobility provision generated sufficient incentive for individuals to prosecute meritorious claims, California could not find this arbitration provision problematic: it was not a "groun[d] ... for the revocation of any contract" as the exception in 9 U.S.C. § 2 provided.[26]

II. CONSUMERS BENEFIT FROM THE FREEDOM TO PRE-COMMIT TO INDIVIDUAL ARBITRATION IN LIEU OF CLASS ACTIONS.

As a threshold matter, it is worth considering whether permitting consumers to enter into contracts with arbitration clauses that preclude class action remedies benefits consumer welfare.

The courts and scholars offended by the *Concepcion* decision and AT&T Mobility's arbitration clause at issue in the case adopt reasoning that treats the class action procedure as an end in itself, rather than as a means to an end. But such logic is flawed; class action lawsuits are but a *means* of consumer protection, intended to permit vindication of small individual claims that the expense of litigation would otherwise make impossible to vindicate. But class action lawsuits are not the only mechanism enabling such a goal. It is a mistake to automatically assume that the interests of class action attorneys run parallel to those of consumers. Rather, as existing class action practice shows, the two groups are often at loggerheads.

Look at the type of arbitration provision that passed muster in the Supreme Court. AT&T Mobility covers the costs of the arbitration; consumers are entitled to a bounty if they win.

That is remarkable in two ways. First, consider how much money AT&T Mobility is willing to spend to avoid class actions, and imagine how much it must be saving by using alternative dispute resolution. Why is that not a damning indictment of the class action process as a means of vindicating consumer rights? Indeed, this leads to my second point. I have been an attorney representing class members objecting to or seeking relief in dozens of consumer class action settlements, and in every one of them, injured class members would have been better off with the AT&T Mobility provision than with what the class action system got them. In *Concepcion*, "the District Court concluded that the Concepcions were better off under their arbitration agreement with AT&T than they would have been as participants in a class action."[27]

Certainly, there are scholars who view the purpose of the class action as the creation of deterrence,[28] but they are mistaking a collateral benefit with the underlying procedural purpose of the class action. As the Supreme Court has consistently held, the class action is a procedural joinder device. We accept that an attorney has the power to release the claims of absent class members without explicit consent for the sake of judicial efficiency only because the federal rules require that the due-process rights of absent class members be protected through an adequate-representation requirement[29]—and that necessarily means that the class attorneys should be viewed as having a duty to specific groups of *clients* rather than as being private attorneys general seeking to impose particular public policy goals for the good of society at large. Thus, treating the tail of the procedure to be wagging the dog of the substantive law is invariably viewed by the Supreme Court as a mistake—whether that mistake benefits plaintiffs or defendants.[30]

In short, there is nothing exceptional about a class action in vindicating individual rights. The unconscionability rule adopted by the California Supreme Court and applied by the Ninth Circuit in *Concepcion* incorrectly presumed that class actions in practice must be available for the vindication of certain consumers' rights, and therefore that courts must strike down a clause requiring mandatory individual arbitration as exculpatory and thus unconscionable. Both economic theory and empirical evidence demonstrate that these presumptions are incorrect, for three reasons.

First, class treatment is neither the only, nor necessarily the best, means of providing aggrieved consumers with meaningful relief. In fact, class action litigation suffers several pathologies that often make it a poor vehicle for the vindication of consumer rights: it is expensive, raising costs to consumers in the long run; it is slow-moving, bringing relief, if at all, long after class members have been harmed; even when class plaintiffs do succeed, class members face significant barriers to obtaining recovery; and class settlements often are a boon for class action attorneys but a bust for class members who recover little or nothing of value.

Second, arbitration is superior in many cases to class actions in vindicating consumer rights. Individual arbitration provides swift resolution of disputes; allows for easy and complete recovery; and does not pit the interests of consumers against an attorney tasked with representing their interests. Indeed, consumers consistently report that they prefer pursuing their claims in arbitration to class action litigation. Therefore, both for the individual complainant and for aggrieved individuals in the aggregate, a contract selecting individual arbitration often will afford consumers a better mechanism for obtaining meaningful relief than class action litigation.

Third, if class actions are a superior vehicle for vindicating consumer rights, there is no need to mandate their availability with respect to small-claims consumer class actions: market mechanisms will make them available to consumers. The marketplace includes a variety of mechanisms for addressing consumer complaints and reflects consumer preferences among these various dispute resolution mechanisms. In addition, selecting efficient complaint-resolution processes allows firms to pass cost savings along to consumers in the form of lower prices.

A. Even Successful Class Actions Frequently Fail to Provide Consumers with Meaningful Relief.

Class actions were designed to provide injured parties with a more efficient means of accessing justice, by aggregating claims for violations of individual rights.[31] Some commentators tout class actions as exceptional vehicles for vindicating consumer rights.[32] In practice, however, class actions have three significant structural deficiencies that often prevent consumers from obtaining meaningful relief.

First, even when the class members are awarded relief in some form, the average class action takes years to reach a settlement; thus, class members must wait a long time before they benefit from a successful class action. Second, even when the class action results in a victory for the class members, obtaining relief may require navigating byzantine procedures that impose significant transaction costs. Third, too often class actions reach settlements that reward class members with pennies on the dollar, if that. Taken together, these three problems result in many class actions that fail to provide consumers with meaningful relief for the violation of their individual rights.

1. Delay in Recovery

The nature of even successful class actions frequently leads to long delays before class members receive relief. The "typical class action" is characterized by "procedural complexity and slow pace."[33] A recent study of all class action settlements in federal courts in 2006 and 2007 found that consumer class actions on average take more than three years from the inception of the litigation to settlement.[34] Data from the states show similarly slow class action litigation. In California, for example, class actions take more than two years to proceed from filing to settlement or verdict at trial.[35] These studies may actually understate the delay because class recovery could be further delayed by the appeal of the approval of a class action settlement.[36]

Because a dollar today is worth more than a dollar tomorrow, the loss of the time value of money is an affirmative harm. And to the extent that delay increases the class attorneys' ability to claim greater fees vis-à-vis the settlement fund by inflating the lodestar, the delay harms class members by reducing their compensation. It is difficult to conclude that consumers receive meaningful relief when they receive it years after they have suffered harm.

2. Obstacles to Recovery

Even when class actions reach a final resolution that is favorable to consumers, it is still difficult for class members to obtain recovery. This difficulty follows from structural inefficiencies in the class action mechanism. Two significant practical difficulties are involved in delivering compensation to consumers.

First, the administrator of the class settlement fund or class damages award must identify the class members and notify them of the settlement or favorable judgment.[37] But even when individual class members are identifiable by name, it may not be feasible to find current addresses for most of them.[38] In theory, "publication notice" (notifying class members of settlement or judgment through advertisements in major periodicals) may compensate for lack of individual notice; but in practice, it, too, may prove ineffective.[39] Therefore, the available data indicate that identifying and notifying absent class members of their right to recovery "will often prove to be both difficult and inefficient."[40]

Second, class members may have to decipher and complete a complex settlement notice and claim form in order to receive compensation under the class settlement.[41] For example, the FTC objected to a recent class action settlement that not only "release[d] the claims of some 500,000 class members for, at best, pennies on the dollar" but did so in a way that required consumers to fill out a detailed and confusing questionnaire to obtain relief and thus "appear[ed] purposefully designed to make it difficult for consumers to make claims."[42] In a case I recently argued to the Third Circuit, the five-page claim form had told class members that they needed to provide evidence of the date of purchase to make a claim for more than $5, but the district court adjudicated the settlement as fair because class members could have submitted photographic evidence of product ownership; it's little wonder that class members made claims on less than a tenth of the settlement fund.[43] Similarly, in *Dewey* v. *Volkswagen AG*,[44] the Third Circuit and the district court disagreed as to whether owners of a million vehicles in an uncertified subclass were allowed to make claims for repair reimbursement from a settlement fund.[45] If sophisticated judicial officials could not parse the notice and settlement and come to the same conclusion, how could class members be expected not to err a substantial percentage of the time?

Indeed, the incentives for class action attorneys and defendants encourage the creation of claims processes that make it prohibitively difficult for class members to make successful claims. The structure of class actions encourages tacit collusion between class attorneys, who are trying to maximize the apparent value of the class settlement and thus their claim to fees, and defendants, who seek to minimize the costs of settlement.[46] By agreeing to a settlement process that appears to provide meaningful relief, but in operation imposes obstacles to actual relief, class attorneys and defendants can maximize the attorneys' fees and minimize the settlement costs to their mutual benefit at the expense of the class members.[47] The creation of artificial obstacles to relief is all too common because the award to the class and the agreement on attorney fees represent a package deal to defendants in class actions. When district courts fail to inquire into actual claims rates and class recovery and instead accept exaggerated fictional assumptions about the size of the settlement, any incentive for the class attorneys not to go along with the defendants' desire to minimize claims is eliminated.[48]

Such transaction costs may explain the "modest to negligible" claims rates in small-claims class actions where the settlement requires class members affirmatively to file claims.[49] For many consumers in such circumstances, it is simply not worth the hassle to pursue their claims. The concern of the Ninth Circuit in *Concepcion*, then—that individual arbitration was procedurally deficient because many individuals would not bother to seek relief through the arbitration process[50]—is neither unique to arbitration nor solved by class actions.

As Omri Ben-Shahar argues, the obstacles to recovery mean that the class action can end up as regressive wealth redistribution because the costs of litigation are borne across the board, but higher-educated consumers are better situated to take advantage of the claims process.[51] If anything, Ben-Shahar understates the problem, because the majority of the litigation costs go to relatively well-to-do attorneys (plaintiffs and defense) and experts and claims administrators, rather than to consumers.[52] The degree to which the class action system benefits attorneys, rather than class members, leads to my next point.

3. Inadequate Compensation

Although most successful class action litigation under Rule 23 is resolved in the form of a class settlement, such class settlements frequently provide little or no meaningful compensation to consumers. Indeed, a significant number of consumer class settlements do not provide consumers with any monetary relief whatsoever. This systematic under-compensation is the product of two structural problems in class actions. First, because class attorneys' fees generally come from the same source as the class members' compensation—the defendant—class attorneys settling class claims have a fundamental conflict of interest.[53] Second, to the extent that class attorneys exploit that conflict of interest, judges lack the necessary information or incentive to rectify self-dealing in most cases.

The principal reason for the failure of many class settlements to provide meaningful compensation is obvious: class attorneys have incentives to engage in self-dealing during the negotiation of class settlements, which often occur simultaneously with the negotiation of attorneys' fee payments.[54] Because class members, especially those in a small-claims consumer class action, have small stakes in the case and therefore usually do not closely monitor their attorneys' conduct, class attorneys often are able to obtain high fees without obtaining meaningful compensation for class members.[55]

Indeed, all three branches of government have recognized this economic reality. In enacting the Class Action Fairness Act (CAFA) of 2005,[56] Congress found that "[c]lass members often receive little or no benefit from class actions, and are sometimes harmed, such as where ... counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value."[57]

Similarly, the FTC has recognized that "[e]xcessive class action attorney fee awards represent a substantial source of consumer harm."[58] Indeed, the agency, at least in the Bush administration, objected to class settlements that it has concluded do not adequately protect consumers from self-dealing by the class attorneys.[59]

Courts also have recognized the harm to consumer welfare caused by the class attorney's conflict of interest.[60] As Judge Friendly put it, "a juicy bird in the hand is worth more than the vision of a much larger one in the bush."[61] In other words, "the negotiator on the plaintiffs' side, that is, the lawyer for the class, is potentially an unreliable agent of his principals," given the possibility that he may trade a small class award for the relatively certainty of a high fee award.[62]

The empirical evidence indicates that in a significant number of cases, this conflict of interest leads to an inadequate class settlement. For example, the Senate report to CAFA canvassed a number of cases that illustrate that "state court judges ... readily approv[e] class action settlements that offer little—if any—meaningful recovery to the class members and simply transfer money from corporations to class counsel."[63] And a RAND study found that the class attorneys' fee awards were greater than the total cash payment to class members in the state-court consumer class actions that were examined.[64] "[C]lass counsel were sometimes simply interested in finding a settlement price that the defendants would agree to" accept regardless whether it adequately compensated the class members.[65]

This risk of under-compensation may be particularly acute in consumer class actions. The Fitzpatrick study of federal class action settlements indicates that a higher proportion of consumer class actions than class actions in general are: (i) certified as settlement classes; and (ii) involve nonmonetary relief in whole or in part.[66] Settlement classes increase the risk of a "reverse auction" in which plaintiffs' attorneys compete to offer a defendant the lowest settlement price.[67]

In addition, the Fitzpatrick study indicates that nonmonetary relief, which is less likely to compensate class members, may be more prevalent in consumer class actions. The study found that 26 percent of consumer class actions in the data set provided for no cash relief at all; 30 percent included in-kind relief, in the form of coupons, vouchers, and the like, as at least part of the relief granted; and 37 percent involved injunctive or declaratory relief of some sort.[68] These data are particularly troubling because consumers are far less likely to be adequately compensated by in-kind or injunctive relief.

Coupon settlements. It is easy to see why class attorneys and defendants may prefer coupon settlements. They can use coupons to inflate the apparent value of the proposed settlement by claiming that the coupons' nominal value is the actual value to the class members.[69]

Coupon settlements, however, suffer from several flaws, including that "they often do not provide meaningful compensation to class members."[70] Indeed, in general, "[c]ompensation in kind is worth less than cash of the same nominal value,"[71] particularly in the case of nontransferable coupons.[72] Moreover, coupons often include "restrictions intended to make redemption difficult."[73] Unsurprisingly, therefore, the redemption rate for a coupon without a secondary market is a minuscule 1–3 percent, and cases abound in which only a few class members redeem their coupons.[74]

Although CAFA was partly designed to discourage the use of valueless coupons,[75] it does not apply to all class actions, and recent coupon settlements indicate that the problem persists. In Washington, D.C., a court recently approved a coupon settlement involving Envision EMI, an organizer of 2009 inauguration conferences.[76] According to the class complaint, 15,000 students paid over $2,300 to attend the conferences, but Envision EMI did not deliver what was promised. The class settlement provides the class members with two $625 coupons to attend future Envision EMI conferences—with the possibility that class members would not be able to use their coupons to attend the conference of their choice, given that only 10 percent of seats at any given conference will be allowed to redeem coupons. The court approved the settlement over the objection of several state attorneys general. Thus, the coupons help Envision EMI stay in business and force the class members to deal with the same firm that they allege failed to deliver a conference worth the more than $2,300 that they paid to attend it.

In another case, Missouri courts permitted class attorneys to walk away with $21 million in cash—twice a likely inflated lodestar—by valuing the unlikely-to-be-redeemed coupons at 100 percent of face value.[77] Worse, a number of federal courts have permitted settlements to avoid CAFA scrutiny by the simple use of a thesaurus to recharacterize "coupons" subject to CAFA as "gift cards" or "injunctive relief" that need no special treatment.[78] Surely CAFA's distaste for coupons was not merely a matter of semantics.

Cy pres. To the extent that CAFA has undermined the use of coupon settlements as a means for class attorneys to increase their fees at the expense of consumers, new tactics have taken their place. Thus, although CAFA addresses some self-dealing, it has also created a game of Whac-A-Mole in which class attorneys have created new methods for tacit collusion.[79]

One such tactic is the use of *cy pres* class settlements. In its original context, courts used *cy pres* to "give effect to a testator's intent" when a specified charitable gift "had been rendered impossible or impracticable because of exigent circumstances"; *cy pres* allows the court to "put[] the funds to the next closest use."[80] In theory, *cy pres* is a solution to the problem that occurs when class members do not receive compensation because few members make a claim on the settlement fund or when allowing direct claims would be prohibitively expensive.[81]

But in practice, *cy pres* "creates the illusion of class compensation."[82] For example, the court may order the defendant to make a payment of goods or services to a third-party charity while paying the class attorneys a fee—and the resulting benefits may redound only to the class attorney, the defendant, and the charity.[83] Like coupon settlements, *cy pres* may be used to "disguis[e] the true cost of a settlement to a defendant to maximize the share of the actual recovery received by the plaintiffs' attorneys."[84] If the charitable contribution is one that the defendant was making, anyway, the effect on the defendant is one of a change of accounting entries rather than any cost to the defendant or benefit to the class aside from the attorneys' fees.[85] The good news is that federal courts are starting to crack down on such abuses, if inconsistently.[86]

One solution would be to cease permitting class attorneys to simply recover based on the percentage of the settlement fund without regard to who actually gets the money from the settlement fund. If, as in the *Bayer* case, class attorneys are allowed to ask for $5.1 million from a $15 million settlement fund even though class members will ultimately receive less than $0.25 million of that fund,[87] class attorneys will never have the incentive to structure claims processes to ensure that class members will actually benefit from a settlement. Judge Lee Rosenthal correctly recognized the need to structure incentives *ex ante*, and discounts *cy pres* in calculating settlement benefit.[88]

Settlement benefits are similarly exaggerated by including the standard notice costs and settlement administration costs in the gross settlement fund. This falsely assumes that class members are indifferent between whether settlement money goes to third-party settlement administrators (often with relationships with class counsel) or to the class. Moreover, notice is a benefit to defendants, not the class: it is constitutionally adequate class notice that permits defendants to enforce the waiver and release in a settlement upon absent class members.[89]

And sometimes the attorneys don't even bother to pretend that the settlement benefits the class. Many class actions involve settlements in which the class attorneys receive fees that are disproportionate to the relief purportedly designed to benefit the class members. For example, the settlement in *In re Bluetooth Headset Products Liability Litigation* did not afford class members any monetary benefit but provided for $100,000 in *cy pres* awards to charities and $850,000 in attorneys' fees.[90] This type of rent-seeking by class attorneys is all too common and does not benefit class members.

Injunctive relief. All too often, courts approve settlements that purport to provide injunctive relief without determining whether the injunctive relief will actually benefit the class members supposedly represented by class counsel. In a case alleging that gasoline vendors are committing consumer fraud by failing to disclose the basic law of physics that liquid expands with temperature, one vendor settled by promising to provide "temperature-adjusted" gallons to consumers in the future. The district court accepted the economically illiterate reasoning that, because such gallons will be slightly larger in volume on average, it meant that future consumers, which would include some class members, will be getting free gasoline—as if the defendant could not adjust its prices to reflect the higher marginal costs.[91]

In class action litigation over the sugary spread Nutella, two federal district courts accepted claims that changing the product's slogan from "An example of a tasty yet balanced breakfast" into "Turn a balanced breakfast into a tasty one" was compensation for the former slogan's alleged consumer fraud—though the attorneys who appeared in the New Jersey class action were unfortunate to have their fee request shaved from $3.7 million to $1.1 million when a California federal judge rubber-stamped a similarly bloated fee for the identical settlement.[92]

The problem is that courts do not consistently evaluate the difference between prospective injunctive relief and retrospective injunctive relief, a difference that is critical in the consumer class action context. Prospective injunctive relief is not a benefit to the class. No changes in future disclosures will benefit consumers who have already been misled by previous statements.[93] Prospective injunctive relief does not compensate class members for past injuries.

Two hypothetical settlements demonstrate the problem with attributing prospective injunctive relief in a misrepresentation case to be a benefit to the class. Imagine the hypothetical consumer fraud class action *Seinfeld* v. *Kramer Non-Fat Yogurt*, where a class sues a shop selling "non-fat yogurt" that turns out to be full of fat.[94] If the parties settled for injunctive relief whereby the defendant agreed to correctly label its full-fat yogurt in the future, that would be of no benefit to the class for their *previous* injuries—even if, as here, there happened to be some overlap between the class members and the set of people who purchased non-fat yogurt in the future. The class members only benefit to the extent that they make additional purchases from the defendant, and that benefit is presumably reflected in the price they pay for those new purchases.

Another example: imagine the hypothetical consumer fraud class action *Gatsby* v. *West Egg*, where the class sues over West Egg selling packages of a dozen eggs that only have ten eggs in them. If the parties settled with injunctive relief that required West Egg to include at least 12 eggs in every "dozen eggs" package, that again provides no benefit to the class for their *previous* injuries, even if, once again, there happened to be some overlap between the class members and the set of people who purchased West Eggs in the future. The lack of benefit becomes even more apparent if West raises its price for a "dozen" eggs from $2.00 to $2.40.[95]

Note the problem of "leakiness" in both these settlements that demonstrates the inherent illusoriness of prospective injunctive relief in a consumer class action. A defendant forced to change business practices by prospective injunctive relief can simply choose to pass along those additional costs to its customers: West Egg customers get 20 percent more eggs than before the settlement but are paying 20 percent more for the package. There is no benefit even to future purchasers, much less the class. An injunction may require a defendant to change its business practices, but if the injunction does not also regulate the defendant's pricing, any increase in the cost of business will be passed along to the consumer.

In contrast, retrospective injunctive relief, provided to class members with durable goods, can be a benefit. For example, in *Hanlon* v. *Chrysler Corp.*,[96] plaintiffs alleged that Chrysler sold vehicles with a defective trunk latch; the case settled with Chrysler agreeing to repair class members' vehicles. That injunctive relief directly compensated the *Hanlon* class: before the settlement, class members owned an allegedly defective vehicle that was hypothetically worth less than what they paid for it; after the settlement, class members owned a vehicle that had been fixed in a recall, increasing its value at the margin. The *Hanlon* settlement may be problematic for other reasons (class members who had already sold or totaled their vehicles received nothing), but to the extent that the settlement was responsible for the retrospective injunctive relief, that injunctive relief was a benefit to the class. Unfortunately, courts all too frequently fail to make the relevant distinction.

Courts also all too frequently fail to inquire into whether the proposed injunction makes any difference at the margin to consumers. Class counsel walked away with a $13 million fee in the meritless *Blessing* v. *Sirius XM*, Inc. class action litigation because they convinced a district court that a five-month offer to provide Sirius subscriptions for $12.99 per month was worth $180 million to class members.[97] This injunctive relief was of little solace to my client and other class members, as they were paying under $5 per month for their service. Any class members who accepted the "relief" would have been nearly $100 worse off than if they had simply called up Sirius and asked for the discounted price.[98] Neither the district court nor the Second Circuit Court of Appeals even tried to refute this truism when rubber-stamping the settlement; both opinions simply ignored the argument and provided no evidence that the court had a reasoned response to it. Class counsel effectively acted as a marketing agent to improve the profits of their purported adversaries rather than as a fiduciary for their clients—though there is virtually no chance that any state bar disciplinary authority would punish class counsel for doing so.

Indeed, in some cases, the problem of under-compensation and self-dealing is so severe that class settlements unambiguously harm class members by putting them in a worse position than they were in before the litigation began. The CAFA Senate report discusses two such cases, including the "infamous Bank of Boston class action settlement," in which an Alabama state court approved a settlement in which the attorneys' fees were subtracted from class member escrow accounts, thus leading, in many cases, to class members losing money to pay the class attorneys' $8.5 million fee.[99]

The problems arising from the class attorneys' conflict of interest are inevitable, but courts do not have any effective means to police all abusive class settlements. Although courts are tasked with ensuring that class attorneys act as fiduciaries for the class as a whole,[100] they often do not have the information necessary to measure whether the class attorney and defendant have arrived at a fair settlement; accordingly, courts cannot easily act to prevent attorney self-dealing.[101] Moreover, courts' incentives are poorly structured: approving an unfair settlement will rarely result in reversal, both because appellate review tends to be deferential and because objectors rarely have the financial incentive to follow through on an appeal. The incentive to follow through with an appeal is perversely muted when an appeal would have a high likelihood of success: class counsel will always have more at stake than an objector will, and a for-profit objector whose appeal might be successful can maximize his financial return by a quid pro quo with the class counsel—being paid to walk away—at the expense of the class. Indeed, for-profit objectors are usually better off if they *lose* objections at the district-court level and proceed with an appeal because that maximizes their chances that they will be paid to go away; such payments are substantially more lucrative than the possibility of fees for a successful objection. This all adds up to courts having little incentive to assess settlement proposals and little information with which to do so.

A court's comparative lack of information may explain the weight that courts afford in reviewing class settlements to the "judgment of the parties," as presented by the attorneys, as to whether the settlement "is fair and reasonable."[102] It perhaps makes sense to defer to the judgment of the parties as to the fairness of a settlement between the defendant and the class members. But given their conflict of interest, class attorneys' judgment cannot be expected to represent the class members' interests fairly in all cases: class counsel wishes to maximize its fees, while the defendant is largely indifferent as to the division of the spoils.[103] Therefore, there is a significant risk that judges will approve class settlements that do not provide meaningful relief to class plaintiffs, particularly when the class relief comes in the form of in-kind or injunctive remedies that are difficult to value.

Courts could do more in consumer class actions to reduce the asymmetries. When confronted with a multi-district litigation and multiple competing class actions, courts often ask the parties to cooperate and divvy up the work amongst themselves. Instead, they should encourage competition: auction off the right to represent the national consumer class to the qualified firm willing to guarantee the highest settlement for the lowest price to the class. If the rent-seeking is competed away, class members will be more likely to benefit.[104]

In sum, class actions are far from an exceptional means of affording consumers meaningful relief. Relief via class action is almost always untimely. Recovering it involves significant transaction costs, and when consumers do obtain such relief, it is often less than they deserve. Thus, in many cases, class actions prove particularly inadequate to the task of affording consumers access to meaningful relief.

B. Individual Arbitration Often Affords Consumers Greater Access to Meaningful Relief.

While class actions are inefficient, typically involving protracted litigation over collateral issues such as discovery and class certification, arbitration provides for a speedy resolution of claims and benefits consumers with small claims by reducing the costs of dispute resolution below its potential expected return. Thus, by comparison, class actions are not exceptional and, indeed, in many cases, are less effective than arbitration in providing consumers with meaningful relief.

The comparative efficiency of arbitration over class remedies and litigation is borne out by empirical evidence. "Virtually every study considering the issue has concluded that results in arbitration are far swifter than those in litigation."[105] For example, a recent study by the Searle Center found that "the average time from filing to final award for the consumer arbitrations studied was 6.9 months."[106] By contrast, federal class actions take more than three years on average to reach settlement. The cost of this delay is borne by the injured class members. Indeed, legal ethics rules prohibiting contact with a "represented party" can be used by plaintiffs' counsel to prevent a defendant from providing satisfactory customer service once a class is certified.[107]

In addition to being more efficient, arbitration offers consumers rates of recovery that are comparable with, and perhaps superior to, class actions. A survey of the empirical literature shows that "most measures—raw win rates, comparative win rates, comparative recoveries, and comparative recoveries relative to amounts claimed—do not support the claim that consumers and employees achieve inferior results in arbitration compared to litigation."[108] Indeed, in many cases, recovery rates in arbitration are likely to be more favorable to consumers than recovery rates in class actions. A 2007 report by the American Arbitration Association showed that approximately 60 percent of arbitrations were settled by mutual agreement or withdrawn; of the cases that reached decision, consumers prevailed 48 percent of the time when they brought the action.[109] By contrast, 80 percent of putative consumer-initiated class actions are never certified,[110] leaving the putative class in those cases with either no recovery or with nuisance levels of recovery, reflecting class counsel's fear of losing the certification motion. Of the remaining 20 percent of putative class actions that are certified, the vast majority settle.[111] Class settlements, moreover, in many cases offer a particularly ineffective vehicle for consumer recovery, given the barriers to recovery and the dead-end problems discussed above. Well-designed arbitration agreements have multiple features designed to avoid these types of problems and thus to provide consumers with a more realistic opportunity at recovery than class actions.

Consumers, unsurprisingly, prefer arbitration over litigation. In 2005, Harris Interactive surveyed 609 adults who had participated in some type of arbitration, finding that they reported several advantages of arbitration over litigation: 74 percent said that it was faster, 63 percent said that it was simpler, and 51 percent said that it was cheaper than litigation.[112] Nearly two-thirds of those surveyed reported themselves likely to arbitrate again, including one-third of those who had lost their claims.[113] And a 2003 study by the American Bar Association of approximately 700 lawyers in its litigation section found that over 86 percent believed that arbitration was as or more cost-effective than litigation, with 75 percent reporting the outcomes in arbitration equal to or better than the outcomes in litigation.[114]

Studies to the contrary are usually cherry-picked or fail to make the appropriate apples-to-apples comparisons. The notorious 2007 Public Citizen study, which outraged readers with a finding that "consumers lost 94 percent of the time," focused solely on collections cases, where consumers lose 96 percent of the time in court:[115]

> Moreover, even in the cases where Public Citizen identifies the business as the prevailing party, the consumer was frequently successful in reducing the amount the business sought. Consumers won reductions in 37.4 percent of the cases that went to hearing, with a median reduction of $824. More impressive, in 3,632 of the 16,054 cases where there was no hearing because the respondent defaulted, the arbitrator refused to award the entire amount the business requested. The median reduction for consumers was $599. This may be because "[i]n cases administered under the NAF Code of Procedure, the arbitrator considers all evidence, whether or not there is a response to the claim." This added layer of protection is unavailable to consumers in civil litigation, where

default judgments are entered on sums certain without consideration of the underlying evidence. The average consumer thus comes out ahead in arbitration, compared with court.[116]

Certainly, class members without meritorious claims will be better off in the class action arena, where the threat of expensive litigation can be used to negotiate an *in terrorem* settlement that benefits the class representative and the class counsel, if no one else. But why would we want to encourage that? The idea that class actions serve a deterrent effect is undermined by the reality of class action practice: good behavior is just as subject to profitable *in terrorem* class actions as bad behavior, so long as a colorable complaint can be constructed. Class actions provide little incentive at the margin to avoid bad behavior. This is why AT&T Mobility finds it preferable to offer a $10,000 bounty to consumers to take it to arbitration.

C. Mandatory Arbitration Clauses Are a Consequence of Consumers' Demand for Lower Prices.

Even assuming that class actions are an exceptional remedy for consumers, there is no need for courts to prohibit consumer-friendly individual arbitration agreements. If class actions are more efficient at providing consumer relief than an arbitration agreement such as AT&T Mobility's, the market will make them available for two reasons. First, the perceived quality of a company's process for resolving customer complaints is reflected in brand image and loyalty, and thus a more efficient process leads to increased demand and the ability to command above-market prices. Second, the efficiency of complaint-resolution processes results in cost savings that are passed along to consumers in the form of lower prices.

Customers implicitly take complaint-resolution mechanisms into account when making purchase decisions. Successful complaint resolution creates positive feelings in individuals toward a company, fostering loyalty and increasing the likelihood of repeat or continued business in individuals who otherwise had a negative experience.[117] Moreover, the quality of a company's complaint resolution is reflected in brand image and reputation, as customers share their experiences through positive recommendations or denigration.[118] Brand image and customer loyalty are significant drivers of purchase decisions, allowing firms with loyal customers and positive brand image to charge a premium over their competitors.[119] Customers are thus, in effect, willing to pay a premium to purchase products and services from companies with effective complaint-resolution mechanisms.

Moreover, to the extent that efficient complaint-resolution processes reduce transaction costs for businesses in resolving complaints, these savings are passed along to consumers.[120] The Supreme Court has long recognized as much in the admiralty context;[121] the same market pressures do not disappear on dry land.[122] To the extent that individual arbitration can lower transaction costs compared with class action litigation and arbitration, customers will directly benefit. Customers may therefore choose companies offering efficient complaint-resolution mechanisms in order to capture these cost savings.

The market already reflects complaint resolution through customer loyalty and pricing. Customers make purchase decisions based on their personal preferences as to the balance of cost and quality of customer service, and they reward companies that provide them with better service at lower prices. Allowing customers to select providers based on their preferences is not substantively unconscionable.

The idea that consumers are unfairly forced into arbitration simply because the clauses are non-negotiable is untenable. As Judge Easterbrook has noted:

> Ever since *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991), enforced a forum-selection clause printed in tiny type on the back of a cruise-ship ticket, it has been hard to find decisions holding terms invalid on the ground that something

is wrong with non-negotiable terms in form contracts. *See also, e.g., Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 (1991) (unequal bargaining power does not justify refusal to enforce an arbitration clause in a form contract); *Seawright v. American General Financial Services, Inc.*, 507 F.3d 967 (6th Cir.2007). As long as the market is competitive, sellers must adopt terms that buyers find acceptable; onerous terms just lead to lower prices. See, e.g., *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir.1997); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir.1996); George L. Priest, *A Theory of the Consumer Product Warranty*, 90 Yale L.J. 1297 (1981). If buyers prefer juries, then an agreement waiving a jury comes with a lower price to compensate buyers for the loss-though if bench trials reduce the cost of litigation, then sellers may be better off even at the lower price, for they may save more in legal expenses than they forego in receipts from customers.

There is no difference in principle between the content of a seller's form contract and the content of that seller's products. The judiciary does not monitor the content of the products, demanding that a telecom switch provide 50 circuits even though the seller promised (and delivered) 40 circuits. It does not matter that the seller's offer was non-negotiable (if, say, it offered 40-circuit boxes and 100-circuit boxes, but nothing in between); just so with procedural clauses, such as jury waivers. As long as the price is negotiable and the customer may shop elsewhere, consumer protection comes from competition rather than judicial intervention. Making the institution of contract unreliable by trying to adjust matters *ex post* in favor of the weaker party will just make weaker parties worse off in the long run. *Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F.2d 273, 282 (7th Cir.1992) ("The idea that favoring one side or the other in a class of contract disputes can redistribute wealth is one of the most persistent illusions of judicial power. It comes from failing to consider the full consequences of legal decisions. Courts deciding contract cases cannot durably shift the balance of advantages to the weaker side of the market; they can only make contracts more costly to that side in the future, because [the other side] will demand compensation for bearing onerous terms.").[123]

Thus, if class actions provide more efficient mechanisms for resolving consumers' complaints than an arbitration agreement, the market will take that into account when pricing products and services. If, however, the arbitration agreement is efficient, the business will be able to pass the cost savings along to consumers in the form of lower prices. In either instance, the market will, without aid from the courts, protect consumer welfare—assuming that consumers have that choice *ex ante* to precommit to arbitration.

The Supreme Court's decision to protect that consumer choice in *Concepcion* has thus benefited consumers. To the extent that consumers—or even a substantial minority of consumers—agree with Public Citizen and trial lawyers about the horrors of mandatory arbitration, businesses will find it profitable to advertise the absence of such clauses from their contracts. It is precisely because consumers are better off in a world where they have the choice of mandatory arbitration that the plaintiffs' bar is aggressively seeking to abolish that choice in the courts, in the legislatures, and in the regulatory arena. Sound public policy requires rejection of those arguments to avoid an unfair wealth transfer from lower- and middle-class consumers to wealthy attorneys.

III. FROM CONCEPCION TO ITALIAN COLORS: THE FUTURE OF CLASS ACTIONS

The Supreme Court's grant of *certiorari* from the Second Circuit's ruling in *American Express* v. *Italian Colors Restaurants*, if the Court reaches a decision on the merits, should help illuminate the scope of *Concepcion*'s holding and the future of class action litigation. In the wake of *Con-*

cepcion, some scholars and activists have argued that the decision will largely eliminate class action litigation. Indeed, in a particularly broad form of this argument, Brian Fitzpatrick has claimed that class actions are dead after *Concepcion*: "Although many commentators have warned that [*Concepcion*] could lead to the end of consumer class actions, this may not even be the half of it: it is possible the decision could lead to the end of class actions against businesses across most—if not all—of their activities."[124]

I disagree. Certainly, *Concepcion* has resulted in the elimination of *some* class actions; Public Citizen identifies 76 class actions short-circuited by courts citing *Concepcion*.[125] And certainly, Fitzpatrick's premise—*Concepcion* means that every class action based in a commercial transaction is potentially subject to an arbitration agreement—is correct. But "potentially subject" does not mean "actually subject."

At a minimum, class actions in the employment- and securities-law arenas should remain commonplace after *Concepcion*. In the consumer context, although the sellers of big-ticket items may find the savings from arbitration sufficient to incur the transaction costs of drafting enforceable arbitration clauses, consumer class actions more broadly should be expected to survive *Concepcion*. In *Italian Colors*, the Supreme Court has the opportunity to clarify the scope of its *Concepcion* holding, but it is unlikely to adopt a rule that precludes all or even most consumer class actions.

Employment class actions. *Concepcion* does not change the law of employment arbitration: the Supreme Court held in 2001 in *Circuit City Stores* v. *Adams* that employers could require arbitration of Title VII claims because arbitration was just a forum-selection clause.[126] The last 11 years have not seen the death of the employment class action in federal court, however. Some employers find requiring arbitration worthwhile; others do not.[127] Even when there are arbitration agreements, federal courts have been willing to let employees argue their way out of them: consider *Jones* v. *Halliburton Co.*,[128] the subject of a recent documentary that had much the same scary claim as Fitzpatrick's paper.[129] Jones attempted to arbitrate her discrimination claim against Halliburton, didn't like the way the arbitration was going, and filed a federal complaint with a whole new set of tort claims that the Fifth Circuit said precluded arbitration, putting Halliburton through a few million dollars of attorneys' fees and much more costly publicity before a jury threw out her claims after trial.[130] (The National Labor Relations Board has attempted to undo *Adams* by declaring mandatory arbitration clauses to be an unfair labor practice, but the courts have been largely skeptical of their position.)[131]

Securities class actions. Similarly, nothing about *Concepcion* changes the world of securities litigation. Fitzpatrick says that nothing stops corporations from requiring shareholders to agree to arbitration rather than class action securities-law remedies, but that was the status quo before *Concepcion*. If corporations could really force public shareholders to arbitrate federal securities claims and derivative shareholder disputes, they would have done so already. But no publicly traded corporation requires arbitration of shareholder disputes because the business community has been reluctant to require arbitration in the securities context absent a safe-harbor ruling from the Securities & Exchange Commission.

Not only has the SEC thus far refused to grant such a safe-harbor ruling, but the commission, without much legal authority, blocked an arbitration clause in an initial public offering (IPO) in the 1980s by Franklin First Financial.[132] The most recent corporation that attempted to innovate by proposing an arbitration clause in its IPO, Carlyle, was quickly mau-maued into withdrawing its proposal.

Carlyle's withdrawal of its proposal is disappointing. Because the provision was to be established in an IPO, no preexisting shareholder would have been "forced" into accepting the arbitration clause. It is far from clear that corporations generally even want arbitration instead of class actions to resolve securities-related disputes; there seems to be a tacit understanding that paying protection money to class counsel in exchange for a broad class waiver is a relatively cheap means of resolving lots of potentially disruptive litigation. That may be rent-seeking and bad public policy and an unfortunate tax on shareholders,[133] but it doesn't mean that defendants don't prefer it. Still, Carlyle's arbitration provision may well have benefited shareholders: the clause would not have prevented the application of penalties routinely meted out by the Department of Justice and the SEC; given that such penalties are sufficiently draconian as to already create principal-agent problems among officers, directors, and shareholders,[134] and given that well over 98 percent of meritorious civil securities litigation is simply piling on existing public disclosures,[135] it is hard to say what permitting parasitical—or worse, meritless—civil litigation adds to investor benefit. One would thus have expected a Carlyle stock with an arbitration clause to trade at a premium compared with securities without an arbitration clause: the boom in the Rule 144A private market[136] suggests how beneficial it is for business entities to avoid the additional marginal litigation and regulation expense from going public.[137] Unfortunately, that natural experiment will have to wait for a braver company or for a different political environment.

Consumer class actions. When it comes to consumer litigation, multiple barriers will keep the class action alive. First, there are transactions costs in shifting from the default rule of "everyone goes to the courthouse" to an arbitration, and most consumer transactions do not have room for those kinds of costs. Thus, if you're buying Bluetooth headsets or Rice Krispies or Breyer's ice cream or diapers or a car seat or gasoline—all of which have been the subject of questionable class action settlements that the Center for Class Action Fairness has recently litigated—it is highly unlikely that the vendor is going to go through the trouble of constructing a process that creates an enforceable arbitration agreement.

That leaves the big-ticket items: cars, long-term cell-phone contracts, financial services. And I fail to see the problem there . These are all competitive markets, and vendors have the incentive to provide competitive services and prices. Forum-selection clauses are part of that bundle. If consumers dislike mandatory arbitration clauses and the lower prices that come with them (for any savings will largely be passed on to the consumer in a competitive market), they will switch companies.

Second, *Concepcion* says only that courts cannot take discriminatorily unfriendly views of arbitration, not that they cannot fairly apply unconscionability doctrines to arbitration clauses. Thus, the extraordinarily friendly arbitration provision in the AT&T Mobility contract makes a huge difference. Federal and state courts still strike down as unconscionable arbitration clauses that are substantially less friendly than the AT&T clause.[138] They perhaps do so more often than *Concepcion* anticipates, but the distaste of many courts for arbitration, combined with other Supreme Court cases prohibiting the use of arbitration to bar claims entirely,[139] means that any arbitration clause cannot impose particularly onerous costs on access to dispute resolution.

In the case of *Italian Colors*, doing so appears to have been civil disobedience of a Supreme Court decision that the Second Circuit did not like.[140] The Second Circuit based its decision on the premise that, in the absence of classwide arbitration, it would be infeasible for an individual claimant to bring an antitrust claim, given the expense of expert witnesses. In a sharply worded dissent from the circuit's decision to deny an en banc (full-circuit) rehearing, Chief Judge Dennis Jacobs, joined by two of his Second Circuit colleagues (in addition to two other dissenters),[141] argued that the court's decision in *Italian Colors* was "incompatible with the longstanding principle of federal law, embodied in the FAA and numerous Supreme Court precedents, favoring the validity and enforceability of arbitration agreements" and that the court's opinion "evaded the broad language and clear import" of *Concepcion*.

Certainly, an antitrust claim alleging an abuse of market power presents a different scenario for arbitration clauses from that of arbitration clauses from participants in a competitive market: we are less concerned about the latter because we can be confident that any gains from the arbitration clause will be passed along to consumers. (That said, this antitrust claim looks particularly weak. Even aside from the fact that so-called tying arrangements are not anticompetitive,[142] American Express hardly has any sort of market power with the retail industry; any number of vendors refuse to do business with it.) But the Second Circuit erred in assuming that class arbitration is the only way to achieve aggregate arbitration. The confidentiality provisions of an arbitration clause need not preclude an attorney from using the same expert witness report in multiple arbitrations and thus making the cost of an expert non-prohibitive; the resulting aggregate litigation will be opt-in, rather than opt-out, but is hardly infeasible. American Express did not help its case by failing to put evidence in the district court that an individual company *could* prevail on a meritorious antitrust claim (and if they lose at the Supreme Court, it will be because the Court refuses to inquire into the fictional findings of the Second Circuit[143]), but, as Judge Jacobs's dissent from rehearing en banc noted,[144] if plaintiffs can defeat arbitration clauses by forcing litigation over the feasibility of proceeding with arbitration, the exception will swallow the rule and destroy the advantages of arbitration to consumers. Corporations seeking to use mandatory arbitration clauses should consider rewriting the clauses to preempt the sort of arguments made in *Italian Colors* with more explicit provisions for voluntary joinder of claims and opt-in aggregate litigation.

But that sort of constraint proves that *Concepcion will* not create the parade of horrors suggested by the academic community. The likely equilibrium will find corporate defendants unlikely to enforce arbitration clauses that do not provide sufficient incentive to prosecute individual claims; one hopes that the Supreme Court's decision in *Italian Colors* is nuanced enough to avoid the dangers Chief Judge Jacobs warned of. Bright-line rules have advantages. That both parties have asked for a holding on narrow grounds within existing precedent, rather than for a broad-sweeping rule, suggests that whatever the Supreme Court decides in *Italian Colors* will have far less effect than what advocates on either side are contending in the run-up to the oral argument.

Class actions have their place in the litigation system, but have been prone to abuse, with disproportionately little of the resulting diversion of wealth from productive sectors of society to the consumers and shareholders whom the class action device was supposed to benefit. The optimal number of class actions is certainly greater than zero but also certainly less than the number we have today. (That 96 percent of all mergers are challenged in aggregate litigation alleging breach of fiduciary duty for failure to disclose, and then almost invariably quickly settled for trivial disclosures, is correctly characterized by Professor Coffee as "polite extortion."[145]) Yet opponents of arbitration have largely failed to address these problems, and treat class actions as an end in themselves, rather than as a means to an end. Giving consumers the choice of pre-committing to arbitration arrangements can reduce this litigation tax, and reduce inequality-exacerbating wealth transfers from lower- and middle-class consumers to wealthy attorneys. And competition from alternative dispute resolution might prompt the organized bar to engage in the sort of reform that better ensures that class action settlements benefit consumers, rather than attorneys.

ENDNOTES

[1] *In re American Express Merchants' Litigation*, 667 F.3d. 204 (2d Cir. 2012), *cert. granted*, 133 S.Ct. 594 (U.S. Nov. 29, 2012) (No. 12–133).

[2] 131 S.Ct. 1740. I founded and manage litigation for the Center for Class Action Fairness, which filed an *amicus* brief for the petitioner in *Concepcion*, co-written by Brian P. Brooks, Charles E. Borden, R. Seth Davis, and myself. Some of the material in this paper originally appeared in that brief; other material in this paper has originally appeared in other briefs filed by Center attorneys, including myself; still other material first appeared on the Manhattan Institute's *Point of Law* website. Any errors in this paper, however, are entirely my responsibility. The Center for Class Action Fairness is not affiliated with the Manhattan Institute.

[3] *E.g.*, Brian T. Fitzpatrick, *Supreme Court Case Could End Class-Action Suits*, SAN FRANCISCO CHRONICLE (Nov. 7, 2010); Editorial, *Gutting Class Action*, N.Y. TIMES (May 12, 2011); Myriam Gilles and Gary Friedman, *After Class: Aggregate Litigation In The Wake Of AT&T Mobility v. Concepcion*, 79 U. CHI. L. REV. 623, 623 (2012) ("Class actions are on the ropes"); Erwin Chemerinsky, *Closing the Courthouse Doors*, 14 GREEN BAG 2D 275 (2011); Ann Marie Tracey and Shelley McGill, *Seeking a Rational Lawyer for Consumer Claims After the Supreme Court Disconnects Consumers in AT&T Mobility LLC v. Concepcion*, 45 LOY. L.A. L. REV. 435 (2012); Jean R. Sternlight, *Tsunami: AT&T Mobility LLC v. Concepcion Impedes Access to Justice*, 90 ORE. L. REV. 703 (2012); Daniel Fisher, *Has Scalia Killed The Class Action?*, FORBES.COM (May 20, 2011), http://www.forbes.com/sites/danielfisher/2011/05/20/has-scalia-killed-the-class-action/ (quoting Public Citizen); *AT&T v. Concepcion Supreme Court Ruling Bad News for Future Class Actions*, GAMEPOLITICS.COM (Apr. 28, 2011) http://gamepolitics.com/2011/04/28/atampt-v-concepcion-supreme-court-ruling-bad-news-future-class-actions (quoting Jennifer Mercurio, Vice President & General Counsel for the Entertainment Consumers Association (ECA) as calling decision "death knell to class action lawsuits").

[4] Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2006).

[5] FED. R. CIV. P. 1-86.

[6] Thomas B. Leary, *The FTC and Class Actions*, FEDERAL TRADE COMMISSION (Jan. 26, 2009), http://www.ftc.gov/speeches/leary/classactionsummit.shtm#N_3_ (last visited Jan. 25 2013); Benjamin Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure*, 81 HARV. L. REV. 356 (1967).

[7] *Stolt-Nielsen v. Animal Feeds International*, 130 S. Ct. 1758 (2010).

[8] *Id.*

[9] *E.g.*, Carter Wood, *Trial lawyers association outlines its 2010 legislative agenda*, POINT OF LAW (Jan. 11, 2010, 5:43 PM).

[10] Even when consumers can opt out of mandatory arbitration clauses *without* paying a higher price, few find it worthwhile to do so. Ebay cleverly took a tactic of giving existing Ebay users an affirmative option to opt out of the mandatory arbitration clause. Despite a campaign by Public Citizen to recruit Ebay customers to do so *en masse*, few did. Ebay gets the best of both worlds: its customer base not subject to arbitration is too small to attract trial lawyers as a target for class actions, while no one can complain that its arbitration clause is unconscionable. One of the reasons that trial lawyers can exploit the class-action device is because few consumers use the opt-out or objection mechanism to complain about unfair class action settlements designed to benefit the attorneys at the expense of their putative clients. *Cf.* Christopher Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 FLA. L. REV. 71 (2007). There is a certain irony that Ebay is using the same transactions-cost problem to preclude class actions in the first place. Given the claims of anti-arbitration advocates that it is the "mandatory," rather than the "arbitration" part of the clause they object to, the business community might wish to call the trial bar's bluff and adopt Ebay-like tactics where feasible, and end any dispute over whether consumers are "forced" into arbitration. Even something as simple as a $5 credit for accepting a default mandatory arbitration clause instead of opting out of it would be telling.

[11] Ted Frank, *Trial lawyers and AT&T Mobility v. Concepcion: arbitration for me, but not for thee*, Point of Law (Dec. 7, 2010, 12:23 PM), http://www.pointoflaw.com/archives/2010/12/trial-lawyers-a-3.php.

[12] *Compare* Public Citizen, The Arbitration Trap, (Sept. 2007) *available at*, www.citizen.org/publications/release.cfm?ID=7545 *with* Peter B. Rutledge, Arbitration: A Good Deal for Consumers (United States Chamber Institute for Legal Reform, April 2008) *and* Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration*, Disp. Resol. Mag., Fall 2008, at 30.

[13] *Id. E.g.*, Maddy Sauer and Justin Rood, *Sex Assault Suit Vs. Halliburton Killed*, The Blotter (Feb. 6, 2008) http://abcnews.go.com/Blotter/story?id=4249898&page=1 (incorrectly stating that lawsuit that would be arbitrated was "killed").

[14] *See* John Warner Defense Authorization Act for Fiscal Year 2007, 10 U.S.C. § 987(b) (2006).

[15] For example, CFPB director Richard Cordray recently complained that 9% of bank customers pay 84% of overdraft fees, with the implication that regulation is needed to correct this supposed imbalance. http://www.consumerfinance.gov/speeches//prepared-remarks-by-richard-cordray-at-the-cfpb-roundtable-on-overdraft-practices/. Of course, as Shannon Phillips points out, what this statistic really reflects is that the vast majority of account holders use their accounts responsibly: if someone in that 9% were to do a better job of balancing their checkbook, they'd move into the 91%. http://themissinglinc.com/2012/05/07/lies-damned-lies-and-statistics/. But CFPB regulation would likely punish the 91% to protect the 9% from themselves. Except that without the overdraft fees, banks will find it unprofitable to serve these customers in the first place, and will instead charge monthly fees that significantly reduce access to the banking system for both the responsible and irresponsible lower middle class. But at least regulators can feel better that they stopped overdraft fees.

[16] *E.g.*, *Discover Bank v. Superior Court of Los Angeles*, 113 P.3d 1100 (Cal. 2005); *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862 (Cal. Ct. App. 2002). Stephen A. Broome, *An Unconscionable Applicable of the Unconscionability Doctrine: How the California Courts are Circumventing the Federal Arbitration Act*, 3 Hastings Bus. L.J. 39, 54, 66 (2006); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buffalo L.Rev. 185, 186-187 (2004).

[17] *E.g.*, *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F. 3d 976 (9th Cir. 2007).

[18] Because class action lawsuits, by definition, include multiple plaintiffs, they uniquely afford plaintiffs' attorneys the opportunity to "shop" their lawsuits to jurisdictions with substantive laws or procedural rules likely to increase the value of their claims. To remedy this forum-shopping problem, in 2005, Congress passed the Class Action Fairness Act, Pub. L. No. 109-2, 119 Stat. 4 (2005) (CAFA), which required that national class action suits with a sufficiently significant amount in controversy are removable to federal court. Nevertheless, the absence of a federal common law under *Erie v. Tompkins*, 304 U.S. 64 (1938), means that even though such class actions are heard in federal court, they apply the substantive law of a forum state. *See generally* Michael Greve, *The Upside-Down Constitution* 221-42 (2012). CAFA has reduced some of the worst abuses of class-action forum shopping, but some federal courts remain better than others for bringing class actions. Ted Frank, *The Class Action Fairness Act Two Years Later*, AEI Liability Outlook, (March 2007), *available at* http://www.aei.org/files/2007/03/27/20070327_Liability.pdf.

[19] *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006); 9 U.S.C. § 2.

[20] *Concepcion*, 131 S.Ct. at 1744. The guaranteed minimum recovery was increased in 2009 to $10,000. *Id.* at 1744 n.3.

[21] *Laster v. AT&T Mobility LLC*, 584 F.3d 849 (2009).

[22] *Id.* at 849 n.9.

[23] *Concepcion*, 131 S.Ct. 1740.

[24] *Id.* at 1747-48.

[25] *Id.* at 1747 (*quoting Perry v. Thomas*, 482 U.S. 483, 493 (1987)).

[26] *Id.* at 1750-53.

[27] *Id.* at 1753.

[28] *E.g.*, Brian Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. Penn. L. Rev. 2043, 2047 (2010); *cf.* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 Colum. L. Rev. 1534 (2006).

[29] Fed. R. Civ. P. 23(a)(4); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 811–12 (1985); *see generally Wal-Mart v. Dukes*, 131 S.Ct. 2541, 2550 (2011).

[30] *E.g., Shady Grove Orthopedic Associates v. Allstate Ins.*, 130 S.Ct. 1431 (2010) (federal plaintiffs have right to bring class action, notwithstanding state law precluding use of class action to seek punitive damages); *Dukes*, 131 S.Ct. 2541.

Even in terms of deterrence, the class action is a clumsy device. Because attorneys' incentives are to bring "big" cases, rather than "high-merit" cases, the deterrence value is substantially undermined. Bank of America gets sued over its overdraft fees because it's big, rather than because it did something wrong. (The Southern District of Florida MDL that Bank of America settled paid class members nine cents on the dollar of alleged damages, but the class attorneys $123 million for what was virtually a nuisance settlement.) And if Bank of America actually did something wrong, the attorneys willing to settle quick and cheap lets it get away with that, because they have still made billions on something the attorneys claim was illegal. When attorneys can wildly profit from nuisance settlements against deep pockets because they do not have to ensure that their clients actually receive any proceeds, deterrence is hurt, because the good companies are getting taxed by the class action system almost as much as the bad actors are.

[31] *See* Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. Chi. Legal F. 71, 71, 77 (2003).

[32] *E.g.*, J. Maria Glover, *Beyond Unconscionability: Class Action Waivers and Mandatory Arbitration Agreements*, 59 Vand. L. Rev. 1735, 1738 (2006); National Association of Consumer Advocates, *Standards and Guidelines for Litigating and Settling Consumer Class Actions*, 176 F.R.D. 375, 377 (1998).

[33] John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 Colum. L. Rev. 669, 710 (1986).

[34] Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. Empirical Legal Stud. 811 (2010).

[35] *See* Office of Court Research, Administrative Office of the Courts, Findings of the Study of California Class Action Litigation 2000-2006: First Interim Report 15-16 (Mar. 2009), *available at* http://www.courtinfo.ca.gov/reference/documents/class-action-lit-study.pdf.

[36] *See generally* Fitzpatrick, *The End of Objector Blackmail*, 62 Vand. L. Rev. 1623,1624 (2009).

[37] *See* Fed. R. Civ. P. 23(e)(1); Martin Redish et al., Cy Pres *Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617, 618-19 (2010).

[38] *See* Robert H. Klonoff *et al., Making Class Actions Work: The Untapped Potential of the Internet*, 69 U. Pitt. L. Rev. 727, 730-31 (2008).

[39] *See id.* at 731-32.

[40] Redish, *supra* note 37, at 618; *accord* Klonoff, *supra* note 38, at 748.

The problem is especially troubling in the securities context, where I have found that the pattern and practice is for settlement administrators to delay requests for lists of individual class members from brokers so that individualized notice goes out too late for such class members to actually object to unfair settlements or fee requests. When the class member complains about the late notice, the settling parties pretend to be surprised that the broker took several weeks to provide the list of individual names, and point fingers at the broker—even though brokers rarely, if ever, provide the instantaneous response to the settlement administrator that the administrator's notice procedures assume. Of course, courts presume that parties intend the reasonably expected consequences of their actions. Should the securities defense bar continue to agree to notice procedures that inevitably result in inadequate notice to class members, securities litigation defendants could find themselves in an unfortunate situation where they have paid millions of dollars to settle a case without obtaining an enforceable waiver; all it would take is an entrepreneurial plaintiffs' lawyer to bring a second class action on behalf of shareholders who did not make claims the first time around, together with perfunctory discovery of the settlement administrators' expectations. *Cf. Hecht v. United Collection Bureau*, 691 F.3d 218 (2d Cir. 2012) (refusing to enforce class action settlement waiver where parties failed to give adequate individualized notice). The malpractice liability would be tremendous; it is surprising that defense attorneys countenance such tactics by plaintiffs to deter objections from individual investors who are unlikely to have the incentive to file a substantive objection.

[41] *See* Class Action Fairness Act of 2005 ("CAFA"), Pub. L. No. 109-2, § 2, 119 Stat. 4, 4 (Feb. 18, 2005); *see also* S. Rep. No. 109-14, at 4 (2005) (Senate Report on CAFA).

[42] Intervener FTC's Mot. for Stay 1, 17-18, *Cass v. AmeriDebt, Inc.*, No. 01 CH 20350 (Ill. Cir. Ct. 2004), *available at* http://www.ftc.gov/os/2004/04/040412motion4stay.pdf.

[43] *In re Baby Products Antitrust Lit.*, No. 12-1165 (3d Cir.).

[44] 681 F.3d 170 (3d Cir. 2011).

[45] *Compare id.* at 176 *with Dewey v. Volkswagen*, 728 F. Supp. 2d 546, 597 (D.N.J. 2010).

[46] *See generally* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. Chi. L. Rev. 877, 883-84 (1987) ("The classic agency cost problem in class actions involves the 'sweetheart' settlement, in which the plaintiff's attorney trades a high fee award for a low recovery.").

[47] In some cases, the complexity of a proposed settlement could lead to consumer harm. The FTC objected to the proposed settlement in *Chavez v. Netflix, Inc.* on this very ground, because the proposed relief was a "free one-month upgrade" combined with a "negative option plan" that meant that "new or upgraded service will continue automatically, and the member will be billed accordingly, unless he or she takes steps to cancel or modify the subscription." FTC's Mem. of Law as *Amicus Curiae* 2, No. CGC-04-0434884 (Cal. Super. Ct. Jan. 5, 2006), *available at* http://www.ftc.gov/os/2006/01/netflixamicusbrief.pdf. As the FTC explained, the negative option was "more of a promotional vehicle for Netflix than compensation for consumers." *Id.* at 10. In at least one other case, the settling parties relied upon the inattention of the district court to perform a bait-and-switch and provide class members substantially less relief than what was promised in the settlement notice; the class counsel, notwithstanding its fiduciary duty to the class, hired an expert to argue against the more favorable interpretation of the settlement proposed by class members who complained about the surprise. Ronald Barusch, *Dealpolitik: The Good, the Bad and the Ugly of Class Actions*, Wall St. J. (Mar. 24, 2011), *available at* http://blogs.wsj.com/deals/2011/03/24/dealpolitik-the-good-the-bad-and-the-ugly-of-class-actions; Ted Frank, *Court rules for NVIDIA*, Point of Law (May 2, 2011, 2:28 PM), http://www.pointoflaw.com/archives/2010/12/trial-lawyers-a-3.php.

[48] For more on this, *see* Lester Brickman, *Lawyer Barons* 349-56 (2011).

[49] *See, e.g.*, Deborah R. Hensler et al., Class Action Dilemmas: Pursuing Public Goals for Private Gain 459 (Rand Institute for Civil Justice 2000); Gail Hillebrand & Daniel Torrence, *Claims Procedures in Large Consumer Class Actions and Equitable Distribution of Benefits*, 28 Santa Clara L. Rev. 747, 747 (1988) (class action "claims procedures are ill-suited" to ensuring class members obtain compensation); *Sullivan v. DB Investments*, 667 F.3d 273, 329 n. 60 (3d Cir. 2011) (en banc) ("consumer claim filing rates rarely exceed seven percent, even with the most extensive notice campaigns"); *In re Grand Theft Auto Video Game Consumer Litig.*, 251 F.R.D. 139 (S.D.N.Y. 2008) (2676 out of 10 million class members made claims); *Palamara v. Kings Family Rests.*, No. 07-317, 2008 WL 1818453, at *1-*3 (W.D. Pa. Apr. 22, 2008) ("approximately 165 class members" out of 291,000 "had obtained a voucher" under the settlement); Declaration of Dan Rosenthal ¶ 12, *NVIDIA GPU Lit.*, No. 5:08-cv-4312-JW, Dkt.

No. 357 (founder of class action settlement claims administrator testifies that claims rates are typically 0.5% to 1.5%). In the *In re Classmates.com* settlement, class counsel fought long and hard to defend a claims process that would have resulted in less than $60,000 in cash to the class; after two successful objections, the settlement fund eventually was increased to $3.5 million, though that still resulted in just a token payment to hundreds of thousands of class members, and zero to millions more. 2012 U.S. Dist. LEXIS 83480 (W.D. Wash. Jun. 15, 2012).

[50] *Laster*, 584 F.3d at 856.

[51] Omri Ben-Shahar, Arbitration and Access to Justice: Economic Analysis, University of Chicago Institute for Law & Economics Olin Research Paper No. 628 (2013).

[52] Too, it is my experience that class action settlements involving classes from lower-income demographics are more likely to be structured to provide illusory relief to class members that are less likely to object.

[53] *E.g.*, *Mirfasihi v. Fleet Mortgage Corp.*, 356 F.3d 781, 785 (7th Cir. 2004).

[54] *See, e.g.*, John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 Colum. L. Rev. 1343, 1347-48 (1995); Coffee, *supra* note 46, at 883-84; Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 7-8 (1991).

[55] In a now-classic study, Andrew Rosenfeld demonstrated that a class attorney that settles a class action enjoys a "settlement premium" above the average attorney's fee awarded in a class action that proceeds to judgment. *See An Empirical Test of Class-Action Settlement*, 5 J. Legal Stud. 113, 115-17 (1976). This premium is consistent with the hypothesis developed above, viz., that class attorneys will maximize their fees at the expense of the class members' compensation. *See also, e.g.*, Coffee, *supra* note 46, at 883-84.

[56] CAFA, Pub. L. No. 109-2, § 2, 119 Stat. 4.

[57] *See id.* at 4; *see also* S. Rep. No. 109-4, at 33.

[58] R. Ted Cruz, Dir. Office of Policy Planning, FTC, Friend of the Court: The Federal Trade Commission's Amicus Program, Remarks Before the Antitrust Section of the American Bar Association 13 (Dec. 12, 2002), *available at* http://ftc.gov.speeches/other/tcamicus; Deborah Platt Majoras, Chairwoman, FTC, *Comments at the FTC Workshop: Protecting Consumer Interests in Class Actions* (Sept. 13, 2004), *in* 18 Geo. J. Legal Ethics 1161, 1162-63 (2005) (class actions may not "truly serve consumers' interests by providing them appropriate benefits"; encouraging "consumers to carefully scrutinize opt-out notices and class action settlement terms and particularly attorney fee awards that may reduce the total compensation available to consumers").

[59] *See* Cruz, *supra* note 58, at 13 ("Not infrequently, the interests of a private class action attorney may substantially diverge from the interests of the class.").

[60] *See generally* Fed. R. Civ. P. 23(e).

[61] *Alleghany Corp. v. Kirby*, 333 F.2d 327, 347 (2d Cir. 1964) (Friendly, J., dissenting).

[62] *Mars Steel Corp. v. Continental Ill. Nat'l Bank & Trust Co.*, 834 F.2d 677, 681-82 (7th Cir. 1987). In recent years, an interesting claim has arisen that this problem is solved by simply negotiating the attorney fee sequentially to the class relief, sometimes in a separate fund. This is fiction. "Anyone familiar with the most rudimentary principles of economics knows that that sounds better than it is because the money always comes out of the class, whether directly or indirectly." Brian Wolfman & Alan B. Morrison, *Representing the Unrepresented in Class Actions Seeking Monetary Relief*, 71 NYU L. Rev. 439, 504 (1996). The fact that fees may not be negotiated until after the rest of the settlement is resolved makes no economic difference. Settling parties are rational economic actors. Even when the negotiations over fees are severed, the parties know in advance that those negotiations are coming, that the defendants have a reservation price based on their internal valuation of the litigation, and that every dollar negotiated for the class reduces the amount the defendants are willing to pay class counsel. The defendants can further reasonably estimate in advance what plaintiffs will claim their lodestar

to be from their own defense costs. Because these future fee negotiations are not an unexpected surprise, and because the parties know a settlement will not occur unless the parties agree to an attorney-fee clause, the overhang of the future fee negotiations necessarily infects the earlier settlement negotiations. "Even if the plaintiff's attorney does not consciously or explicitly bargain for a higher fee at the expense of the beneficiaries, it is very likely that this situation has indirect or subliminal effects on the negotiations." *Court Awarded Attorney Fees, Report of the Third Circuit Task Force*, 108 F.R.D. 237, 266 (1985); *cf. also Bluetooth*, 654 F.3d at 948 (neither presence of neutral mediator nor separation of fee negotiations from other settlement negotiations demonstrates that a settlement is fair). "In other words, the negotiation of class counsel's attorneys' fees is not exempt from the truism that there is no such thing as a free lunch." *Staton*, 327 F.3d at 964. See also Brickman, *supra* note 48, at 522-25.

[63] S. Rep. No. 109-2, at 14, 33; *see also* John H. Beisner, Matthew Shors, & Jessica Davidson Miller, *Class Action "Cops": Public Servants or Private Entrepreneurs?*, 57 Stan. L. Rev. 1441, 1447-50 (2005) (presenting list of "abusive" class settlements).

[64] *See* Hensler, Class Action Dilemmas, at 14 (profiling case studies), 23 (presenting comparison of attorneys' fees with total cash payments).

[65] *Id.* at 427 (emphasis added).

[66] *See* Fitzpatrick, *supra* note 34.

[67] *See* Howard M. Erichson, *CAFA's Impact on Class Action Lawyers*, 156 U. Penn. L. Rev. 1593, 1606 (2008); Coffee, *supra* note 54, at 1370 (defining "reverse auction").

[68] *See* Fitzpatrick, *supra* note 34.

[69] *See* Geoffrey P. Miller & Lori S. Singer, *Nonpecuniary Class Action Settlements*, 60 L. & Contemp. Probs. 97, 108 (1997); Brickman, *supra* note 48, at 346-49.

[70] *Figueroa v. Sharper Image Corp.*, 517 F. Supp. 2d 1292, 1302 (S.D. Fla. 2007); *see also In re Mex. Money Transfer Litig.*, 267 F.3d 743, 748 (7th Cir. 2001).

[71] *In re Mex. Money Transfer Litig.*, 267 F.3d at 748.

[72] *See, e.g.*, *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 216 F.R.D. 197, 221 n.58 (D. Me. 2003).

[73] *See* Christopher R. Leslie, *A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation*, 49 U.C.L.A. L. Rev. 991, 995 (2002).

[74] *See, e.g.*, James Tharin & Brian Blockovich, *Coupons and the Class Action Fairness Act*, 18 Geo. J. Legal Ethics 1443, 1445 (2005); *Moody v. Sears Roebuck & Co.*, 664 S.E.2d 569, 572, 574 (N.C. App. 2008) (317 valid claims filed out of 1,500,000 member class, for total of $2,402 in total redemption of coupons as compared to more than $1,000,000 in attorneys' fees and costs); *Union Fidelity Life Ins. Co. v. McCurdy*, 781 So.2d 186, 188 (Ala. 2000) (113 redemptions out of 104,000 member class); Jeff Feeley & Myron Levin, *Ford Accord Garners Less Than 1 Percent Participation*, Bloomberg (July 7, 2009) (75 coupons redeemed out of class of 1 million, while class attorneys received $25 million in fees and costs); Daniel Fisher, *St. Louis Judge Hands Lawyers $21 Million For Coupons*, Forbes.com On the Docket (June 23, 2010), *at* http://blogs.forbes.com/docket/2010/06/23/st-louis-judge-hands-lawyers-21-million-for-coupons/ (Missouri class action settlement of $21 million for lawyers compared to $5 million in cash and $34 million in coupons for class).

[75] *See* CAFA, Pub. L. No. 109-2, §§ 2-3, 119 Stat. 4.

[76] *See Radosti v. Envision EMI, LLC*, No. 09-887, 2010 WL 2292343 (D.D.C. June 8, 2010).

[77] *Bachman v. A.G. Edwards, Inc.*, 344 S.W.3d 260 (E.D. Mo. May 31, 2011) (*motion for rehearing and/or transfer to Supreme Court denied*).

[78] *Blessing v. Sirius XM, Inc.*, No. 11-3696 (2d Cir. Dec. 20, 2012) (summary order) (petition for rehearing pending); *In re Online DVD Rental Antitrust Lit.*, No. 4:09-md-2029 (N.D. Cal. 2012) (appeal pending).

[79] *Cf.* Erichson, *supra* note 67, at 1607 ("CAFA's Whac-a-Mole effect manifests itself in several ways.").

[80] Redish, *supra* note 37, at 625.

[81] *See id.* at 618-19; Theodore H. Frank, Cy Pres *Settlements*, Class Action Watch (Mar. 2008), at 1.

[82] Redish, *supra* note 37, at 625.

[83] Frank, *supra* note 81; *see also, e.g.*, Coffee, *supra* note 54, at 1368 (discussing *cy pres* settlement In *re Matzo Food Prods. Litig.*, 156 F.R.D. 600 (D.N.J. 1994), which seemed a clever "way of" allowing the defendant food producer "simultaneously" to "dispos[e] of both stale matzos and a difficult litigation").

[84] Frank, *supra* note 81, at 21.

[85] For example, Kellogg agreed to class action settlements that required it to donate a few million dollars of products to food-banks—something it was already doing to the tune of tens of millions of dollars a year. *Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012) (rejecting settlement). Similarly, in the class action settlement in *In re Bayer Corp. Combination Aspirin Products Marketing and Sales Practices Litigation*, No. 09-md-2023 (E.D.N.Y.), where I have an objection pending, the *cy pres* is targeted for the American Heart Association, which not only already regularly receives money from Bayer, but endorses Bayer's aspirin to the exclusion of other brands of aspirin.

[86] *Compare Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012); Nachshin v. AOL LLC, 663 F.3d 1034 (9th Cir. 2011); *and Klier v. Elf Atochem N. Am.*, Inc., 658 F.3d 468 (5th Cir. 2011); *with Lane v. Facebook*, 696 F.3d 811 (9th Cir. 2012). In *Lane*, the *cy pres* went to a new charity established by defendant Facebook, who could then direct the money to recipients favorable to Facebook's lobbying interests. Roger Parloff, *Google and Facebook's new tactic in the tech wars*, CNN Money (Jul. 30, 2012 12:18 PM), http://tech.fortune.cnn.com/2012/07/30/google-and-facebooks-new-tactic-in-the-tech-wars/.

[87] *Bayer* is not unique. In the pending Third Circuit case of In *re Baby Products Antitrust Litigation*, No. 12-1165 (3d Cir.), the class will receive less than $3 million of a $35 million settlement fund, while the attorneys were awarded $14 million.

[88] *In re Heartland Payment Sys.*, 851 F. Supp. 2d 1040, 1076-77 (S.D. Tex. 2012).

[89] *Hecht v. United Collection Bureau*, 691 F.3d 218 (2d Cir. 2012).

[90] 654 F.3d 935 (9th Cir. 2011). On remand, plaintiffs unsuccessfully asserted that the injunctive relief—trivial warnings of the open and obvious danger of hearing loss from listening to conversations at loud volume for long periods of time—was worth nearly a billion dollars, and the district court reduced the request substantially. In the absence of a public-interest objector willing to take the matter on appeal, the settlement and excessive fee would have been rubber-stamped without incident.

[91] Brickman, *supra* note 48, at 348 & n.58.

[92] Ted Frank, *Food lawsuits*, Point of Law (Aug. 23, 2012, 9:00 AM), http://www.pointoflaw.com/archives/2012/08/food-lawsuits.php. *Contrast in re Nutella Mktg. and Sales Pract. Lit.*, No. 3:11-cv-1086 (D.N.J.) *with In re Ferrero Lit.*, No. 11-CV-205 (S.D. Cal.). Appeals are pending in both cases.

[93] *True*, 749 F. Supp. 2d at 1077; *Synfuel*, 463 F.3d at 654.

[94] *Cf.* Larry David, *Seinfeld: The Non-Fat Yogurt* (NBC Nov. 4, 1993).

[95] Expect the recent class actions brought against Subway over whether their foot-long sandwiches are actually a foot long to settle in such a manner.

[96] 150 F.3d 1011 (9th Cir. 1998).

[97] *Blessing v. Sirius XM, Inc.*, Inc., No. 09 CV 10035HB (S.D.N.Y. Aug. 24, 2011), *aff'd*, No. 11–3696–CV (2d. Cir. Dec. 20, 2012).

[98] *True v. Am. Honda Co.*, 749 F. Supp. 2d 1052, 1077 (C.D. Cal. 2010); *Synfuel Tech v. DHL Express*, 463 F.3d 646, 654 (7th Cir. 2006).

[99] S. Rep. No. 109-14, at 14 (citing *Kamilewicz v. Bank of Boston Corp.*, 92 F.3d 506 (7th Cir. 1996)).

[100] *See* Fed. R. Civ. P. 23(e).

[101] *See, e.g.*, Howard M. Downs, *Federal Class Actions: Diminished Protection for the Class and the Case for Reform*, 73 Neb. L. Rev. 646, 699 (1994); William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 U.C.L.A. L. Rev. 1435, 1445 (2006).

[102] *Jones v. Nuclear Pharmacy, Inc.*, 741 F.2d 322, 324 (10th Cir. 1984).

[103] *Staton*, 327 F.3d at 964 (*quoting In re Gen. Motors Corp. Pickup Truck Fuel Tank Prod. Liab. Litig.*, 55 F.3d 768, 819-20 (3d Cir. 1995)); *accord Bluetooth*, 654 F.3d at 949; *Mirfasihi*, 356 F.3d at 785.

[104] Brickman, *supra* note 48, at 356-60.

[105] Peter Rutledge, *Whither Arbitration?*, 6 Geo. J.L. & Pub. Pol'y 549, 571 (2008) (reviewing empirical studies).

[106] Searle Civil Justice Center, Consumer Arbitration Before the American Arbitration Assoication: Executive Summary (Mar. 2009), at http://www.searlearbitration.org/report/exec_summary.php.

[107] *Cf., e.g., Cobell v. Norton*, 212 F.R.D. 14 (D.D.C. 2002).

[108] Rutledge, *supra* note 105, at 560 (survey of empirical literature).

[109] *See* American Arbitration Association, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload, available at* http://www.adr.org/si.asp?id=5027.

[110] Shannon R. Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does it Make?*, 81 Notre Dame L. Rev. 591, 635-36 (2006).

[111] *E.g., Thorogood v. Sears, Roebuck & Co.*, 624 F.3d 842, 849-50 (7th Cir. 2010), *rev'd on other grounds*, 131 S.Ct. 3060 (2011).

[112] Harris Interactive, Arbitration: Simpler, Cheaper, and Faster Than Litigation (U.S. Chamber Inst. for Legal Reform 2012), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005HarrisPoll.pdf; *see also* Rutledge, *supra* note 105, at 561.

[113] *Id.*

[114] *See* Section on Litigation Task Force on ADR Effectiveness, Survey On Arbitration Q9, Q13 (Aug. 2003), *available at* http://www.abanet.org/litigation/taskforce/adr/surveyreport.pdf; *see also* Rutledge, *supra* note 105, at 561.

[115] Cole & Frank, *supra* note 12, at 31 & n.5.

[116] *Id.* at 32.

[117] *See, e.g.*, Tor Wallin Andreassen, *What Drives Customer Loyalty with Complaint Resolution?*, 1 J. of Serv. Research 324, 329 (1999).

[118] *See, e.g.*, Eugene W. Anderson, *Customer Satisfaction and Word of Mouth*, 1 J. of Serv. Research 5, 6, 15 (1998).

[119] Frederick F. Reichheld & W. Earl Sasser, Jr., *Zero Defections: Quality Comes to Services*, 68 Harv. Bus. Rev. 105, 107 (1990).

Customer loyalty is a particularly strong predictor of firm success. Because existing customers bring increased business at lower costs, customer retention rates have a dramatic impact on a firm's bottom line. *Id.* at 105 (finding that businesses retaining 5% more customers see 100% increase in profit).

[120] *See, e.g.*, Stephen Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. Dispute Resolution 89, 91 (2001); Rutledge, *supra* note 105, at 579-81.

[121] *Carnival Cruise Lines v. Shute*, 499 U.S. 585, 594 (1991).

[122] *See, e.g., Metro E. Ctr. For Conditioning & Health v. Quest Commc'ns Int'l, Inc.*, 294 F.3d 924, 927 (7th Cir. 2002).

[123] *IFC Credit Corp. v. United Business & Indus. Federal Credit Union*, 512 F.3d 989 (7th Cir. 2008).

[124] Brian Fitzpatrick, *Did the Supreme Court Just Kill the Class Action?*, Class Action Watch (Sep. 2011).

[125] Public Citizen & Nat'l Ass'n of Consumer Advocates, *Justice Denied: One Year Later: The Harms to Consumers from the Supreme Court's Concepcion Decision Are Plainly Evident* 32-34 (April 2012), *available at* http://www.citizen.org/documents/concepcion-anniversary-justice-denied-report.pdf.

[126] 532 U.S. 105, 123 (2001).

[127] Moreover, the National Labor Relations Board has decided, for the first time in its history, that mandatory arbitration agreements are an unfair labor practice in some circumstances. *D.R. Horton, Inc. and Michael Cuda*, 357 NLRB No. 184 (Jan. 3, 2012). The ultimate effect of this decision will be to reduce wages and increase unemployment, with a wealth transfer to attorneys at the expense of employees. *Cf.* Testimony of Theodore H. Frank to Senate Republican Conference 4-5 (Mar. 16, 2009).

[128] 583 F.3d 228 (5th Cir. 2009).

[129] *Hot Coffee* (HBO 2011). The U.S. Chamber Institute for Legal Reform has a useful website debunking many of the incorrect claims in the film, http://hotcoffeetruth.com.

[130] For more on the *Jones* case, *see* Ted Frank, *Jamie Leigh Jones lawsuit falling apart*, Point of Law (Jul. 7, 2011, 11:57 AM), http://www.pointoflaw.com/archives/2011/07/jamie-leigh-jon.php, and blog posts and articles cited therein; Mike Tolson, *Jones coverage not a high point for news media*, Houston Chronicle (Oct. 3, 2011).

[131] *Compare Owen v. Bristol Care, Inc.*, No. 12-1719, 2013 WL 57874 (8th Cir. Jan. 7, 2013) *with In re D. R. Horton, Inc.*, 357 NLRB No. 184, 2012 WL 36274 (N.L.R.B. Jan 03, 2012), appeal pending.

[132] Ted Frank, *The Carlyle IPO*, Point of Law (Feb. 6, 2012 8:33 AM), http://www.pointoflaw.com/archives/008941.php; Miles Weiss et al., *Carlyle Drops Class-Action Lawsuit Ban as Opposition Mounts*, Bloomberg (Feb 3, 2012 5:57 PM), http://www.bloomberg.com/news/2012-02-03/carlyle-drops-class-action-lawsuit-ban.html.

[133] *See, e.g.*, *Robert F. Booth Trust v. Crowley*, 687 F.3d 314 (7th Cir. 2012); *Felzen v. Andreas*, 134 F.3d 873, 876 (7th Cir. 1998) (citing academic literature). *See also* Brickman, *supra* note 48, at *373 ff.*

[134] James R. Copland, *The Shadow Regulatory State: The Rise of Deferred Prosecution Agreements*, 14 Manh. Inst. Civ. J. Rpt. 1 (2012).

[135] Dyck, Alexander, Adair Morse, and Luigi Zingales. *Who Blows the Whistle on Corporate Fraud?* The Journal of Finance 65, 6 (2010): 2213-2253 (less than 2% of fraud uncovered by private securities litigation).

[136] Committee on Capital Markets Regulation, http://www.aei.org/files/2008/02/14/20080215_ScottPresentation.pdf.

[137] Again, the result of the litigation burden is a wealth-transfer upwards: middle-class investors do not have access to the benefits of Rule 144A private placements as a matter of regulation, while wealthy investors do. Securities litigation settlements usually also result in wealth-transfers upwards; aside from the millions going from the average investor to wealthy attorneys, securities settlement claims processes almost invariably benefit institutional investors at the expense of individual investors. Cf. Elizabeth Chamblee Burch, *Optimal Lead Plaintiffs*, 64 Vand. L. Rev. 1109 (2011).

[138] *E.g.*, *Chavarria v. Ralphs*, 812 F. Supp. 2d 1079 (C.D. Cal. 2011); *Urbino v. Orkin Services of California Inc.* No. 2:11-cv-06456-CJC(PJWx) 2011 U.S. Dist. LEXIS 114746 (C.D.Cal. Oct. 5, 2011); *Reyes v. Macy's, Inc.*, 202 Cal. App.4th 1119 (2012); *Brown v. Ralphs Grocery Co.*, 197 Cal. App. 4th 489 (2011).

[139] *E.g.*, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985).

[140] In re American Express Merchants' Litigation, 681 F.3d 139, 142-49 (2d Cir. 2012) (Jacobs, J., dissenting from denial of rehearing *en banc*).

[141] *Id.*

[142] Robert Bork, The Antitrust Paradox 372-81; Richard Posner, Antitrust Law: An Economic Perspective 198-202 (2d ed. 2011); George J. Stigler, *United States v. Loew's Inc.: A Note on Block Booking*, 1963 Sup. Ct. Rev. 152.

[143] The brief for respondents, signed by Paul Clement, cleverly asks only for a narrow holding based on that artificial record.

[144] In re American Express, 681 F.3d at142-49 (2d Cir. 2012).

[145] David Nicklaus, *Class-action lawyers swarm around buyout deals*, St. Louis Post-Dispatch (Feb. 7, 2012).

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Mr. FRANKS. Thank you, Mr. Frank.

And I would now recognize our third witness, Ms. Doroshow.

TESTIMONY OF JOANNE DOROSHOW, EXECUTIVE DIRECTOR, CENTER FOR JUSTICE AND DEMOCRACY AT NEW YORK LAW SCHOOL

Ms. DOROSHOW. Thank you, Mr. Chairman, and Members of the Subcommittee.

This oversight hearing is to examine litigation abuses. When I heard of this hearing topic, I was thrilled, of course, because, thanks to countless and ever-increasing kinds of litigation abuses that affect 99 percent of Americans, I thought this is a real opportunity to discuss a very serious issue.

As a result of hundreds if not thousands of so-called tort reform laws that have passed around the country in the last 30 years; a series of recent Supreme Court decisions that have stripped people of their legal rights, including providing corporations the ability to ban class actions; and other action and inaction by Congress; the sick, injured, and violated struggle to get into civil court today.

Indeed, tort cases now represent only 6 percent of all civil cases while monetary disputes, like debt collections, represent 72 percent.

While calling consumer lawyers insensitive to the importance of keeping companies "litigation-free," corporate lawyers run to court at the smallest provocation. The U.S. Chamber of Commerce itself sues the U.S. Government, on average, three times a week.

There are many ways to define litigation abuse, of course. There is discovery abuse by corporate defendants who try to avoid disclosure of critical information they would prefer to keep secret, not only from the plaintiff, but from the public.

I believe budget cuts are abusive. Indeed, it is now being reported that, due to the sequester, Federal civil jury trials may be completely suspended beginning this fall.

As to class actions, these cases are now in freefall. It seems my copanelists may be the only ones who have not gotten the memo on that. Just since *AT&T v. Concepcion* was decided in 2011, allowing corporations to immunize themselves with forced arbitration clauses containing class-action bans, at least 100 class actions—this is according to recent work from Public Citizen—and likely many more have been dismissed.

The claims have not gone into arbitration. They have simply disappeared.

Then there is the *Walmart v. Dukes* case, which, as one corporate lawyer put it, has aided employers to defeat, fracture, and/or devalue employment discrimination class actions.

Employers have not even taken full advantage of Concepcion's forced arbitration and class action bans, but they will.

Other cases have resulted in the widespread dismissal of drug and device cases—*Riegel v. Medtronic*, the Mensing case.

Lawsuits by the sick and injured are now so nonthreatening to the business world that NFIB's own members ranked the issue, which they call "cost and frequency of lawsuits/threatened lawsuits" at number 71 out of 75 issues that small businesses care about. That is a lower rank than how to use Twitter, according to their own survey.

In sum, there is much to discuss when it comes to litigation abuse. I did learn late Monday that, I guess since corporate litigation lobbies have seemingly gotten most everything they have asked for from Congress and the Supreme Court, pending a couple more decisions this term, they have only a few things left to complain about.

One, they do not like it when plaintiff lawyers try to keep truly State cases based on State laws involving few residents in State court where it belongs, or that these attorneys file cases in too few judicial jurisdictions, which they call forum shopping.

Of course, as Mr. Conyers alluded to, one answer to this problem is for the Senate to confirm the 33 nominees currently pending who would love to be hearing cases right now.

And of course, the irony here is that CAFA provides the ultimate in forum shopping to defendants who can decide which court will hear a case that accuses them of wrongdoing.

Another thing they do not like are cy pres awards. When a company steals or cheats people out of millions of dollars, they would like this company never to be held accountable for this if its customers are dead or cannot be found. We do not agree.

As to alternative litigation financing, when someone or their child suffers brain injury, amputation, blindness, quadriplegia, cancer, or another devastating injury at the hand of a corporate wrongdoer, and cannot work, they deserve to be able to bring their case and not be forced into accepting lowball offers from insurance companies simply because they cannot put for food on the table.

Regulation by State bar associations of alternative litigation financing is fine. Banning it or placing control of litigation in the hands of the Federal Government, where the U.S. Chamber of Commerce has outsize influence, is not fine.

There are many steps that Congress can take, such as to prohibit arbitration, class-action bans. I would be happy to discuss some of those laws and bills, if time permits.

And I thank you very much, and would be happy to answer questions.

[The prepared statement of Ms. Doroshow follows:]

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STATEMENT OF JOANNE DOROSHOW, EXECUTIVE DIRECTOR
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BEFORE THE SUBCOMMITTEE ON THE CONSTITUTION AND CIVIL JUSTICE

EXAMINATION OF LITIGATION ABUSES

March 13, 2013

Mr. Chairman, members of the Subcommittee, I am Joanne Doroshow, President and Executive Director of the Center for Justice & Democracy at New York Law School, a national public interest organization that is dedicated to educating the public about the importance of the civil justice system. I am also an Adjunct Professor of Law at New York Law School where I teach Civil Justice Through the Courts.

This oversight hearing is to examine litigation abuses. My testimony will address this topic directly.

As a result of hundreds if not thousands of so-called "tort reform" laws that have passed around the country in the last 30 years, a series of recent Supreme Court decisions that strip everyday people of their legal rights (including providing corporations with the ability to ban all class actions) and other action and inaction by Congress, the sick, injured, defrauded and violated in this country struggle to even get into civil court today. In particular, the new movement towards privatized justice, including forced arbitration, stands in stark contrast to the precepts of conservative economic theory: that the tort system's economic function is deterrence of non cost-justified accidents, with the tort system creating economic incentives for "allocation of resources to safety."[1] But as others have observed, like recent trends towards the privatization of government,[2] the privatization of justice has nothing to do with expanding the free market, but rather expanding "crony capitalism."

It is important to note that while the rights of individuals continue to be limited, major corporations enjoy unfettered access to the courts to recoup their commercial losses resulting from a host of troubles – from trademark violations, contract breaches, patent infringements and other unfair competition claims to property damage, lost goods, unpaid bills or fraud. Indeed,

[1] *See, e.g.*, William M. Landes, Richard A. Posner, *The Economic Structure of Tort Law* (1987).
[2] Paul Krugman, "Lobbyists, Guns and Money," *New York Times*, March 25, 2012, http://www.nytimes.com/2012/03/26/opinion/krugman-lobbyists-guns-and-money.html.

tort cases now represent only 6 percent of all civil cases, having dropped for years, while monetary disputes (including debt collections, which have been soaring since the start of the recessions) represent 72 percent of all civil cases.[3] In a state like Kansas, which keeps uniquely complete court records, in one recent year only 2.1 percent of civil cases were tort cases while 72.8 percent were debt collections.[4] And considering that an enormous number of debt collections are in forced arbitration systems,[5] it becomes clear how dominant this type of case is.

Indeed, while calling consumers' lawyers insensitive to the importance of keeping companies "litigation-free," corporate lawyers run to court at the smallest provocation. The largest "tort reform" corporate lobby in the nation – the U.S. Chamber of Commerce – sues the U.S. government on average three times a week.[6]

Aside from this obvious hypocrisy, there is also the very real problem of discovery abuse by defense litigators. In fact, expense and delay in litigation are often the result of improper attempts by corporate defendants to avoid disclosure of critical information, which they would prefer to keep secret not only from the plaintiff but also from the public. In 1997, I helped write a study on this topic for the consumer group, Public Citizen.[7] We found evidence of repeated abuse by defendants in the pre-trial discovery process. Among the abuses: providing misleading responses to discovery requests – responses that obscured the fact that the defendant was deliberately withholding documents sought by the plaintiff; shielding mountains of documents behind the attorney-client privilege without demonstrating or even confirming that all such documents are subject to the privilege; seeking elaborate protective orders aimed at hiding damaging product information from the public, the media and government agencies – as well as from others who claim injury from the same product; and finally, forcing plaintiffs to agree to forever seal the records of a case – including, sometimes, the transcripts of a public trial. In addition, we found cases where defendants refused to comply even after judicial orders were issued. In other cases, defendants blatantly concealed and destroyed documents relevant to their defective products – often while denying that such records ever existed. These problems are certainly continuing[8] and could become worse under new e-discovery rules.[9]

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[3] Robert C. LaFountain et al., *Examining the Work of State Courts: An Analysis of 2010 State Court Caseloads*, National Center for State Courts (2012) at 11, http://www.courtstatistics.org/Other-Pages/CSP2010.aspx.

[4] Robert C. LaFountain et al., *Examining the Work of State Courts: An Analysis of 2007 State Court Caseloads*, National Center for State Courts (2009) at 10, http://vis-res.com/pdf/examining2009.pdf.

[5] *See, e.g.*, Public Justice Comments to Bureau of Consumer Financial Protection In Response to Request for Information for Study of Pre-Dispute Arbitration Agreements, Docket No. CFPB-2012-0017, June 23, 2012, http://publicjustice.net/sites/default/files/downloads/PublicJusticeCommentsToCFPB_ReMandatoryArbitration_Jun2012.pdf.

[6] Chad Hemenway, "Regulators Are 'Taking Over the Joint': U.S. Chamber of Commerce CEO," *National Underwriter*, January 16, 2013, http://www.propertycasualty360.com/2013/01/16/regulators-are-taking-over-the-joint-us-chamber-of.

[7] David Halpern, *Discovery Abuse: How Defendants in Products Liability Lawsuits Hide and Destroy Evidence*, Public Citizen (July 1997), http://www.citizen.org/congress/article_redirect.cfm?ID=918.

[8] *See, e.g.*, "Court Awards $750,000 as Civil Contempt Sanction For Discovery Abuse," *E-discovery Case Law Update*, April 15, 2011, http://www.ediscoveryemploymentcounsel.com/federal-court/court-awards-750000-as-civil-contempt-sanction-for-discovery-abuse/

[9] These rule changes are before the Advisory Committee on Rules and I will not address them in this testimony.

In sum, this is how I would define litigation abuse. This is not how our Founding Fathers envisioned the nation as they fought the Revolutionary War in significant part over England's repeated attempts to restrict jury trials for everyday people and nearly defeated the U.S. Constitution over its failure to guarantee the right to civil jury trial – a problem eventually resolved by the Seventh Amendment.

BUDGETS AND CAFA

There are other forms of litigation abuse as well. I will now turn to budget cuts and the sequester, which threaten the very existence of this constitutionally-protected institution. Recently, the American Association for Justice, DRI – The Voice of the Defense Bar and the American Bar Association joined together to issue a dire warning about the impact of sequestration on our courts. They said, "Severe and indiscriminate federal court budget reductions through sequestration combined with chronically anemic state funding for courts threaten access to justice for every American and put court petitioners, staff and judges in physical jeopardy."[10] Indeed, it is now being reported that federal civil jury trials may be completely suspended beginning this fall.[11]

In California, severe budget cuts are causing courthouse after courthouse to close. As explained by Judge Michael L. Stern of the Los Angeles Superior Court,[12] "Although there will be some closures and adjustments to criminal courts, constitutional and public safety imperatives dictate that criminal prosecutions will not be much impacted…." In other words, the civil justice system will principally take the hit. Expenses will go up dramatically for litigants, hitting the economically-disadvantaged hardest. Litigators there say it will take 3 to 4 years for a case to get to trial. Defendants typically do not settle cases without timely trial dates so the entire civil justice process will be impeded.

When it comes to class actions, these new federal cuts are exacerbating an already severe problem of clogged federal courts. In testimony before this very committee less than a year ago, Thomas M. Sobol of Hagens Berm Sobol Shapiro testified that the Class Action Fairness Act of 2005 (CAFA) has resulted in the routine denial of multistate class certification – especially when multiple states laws are at play.[13] One reason for this is that CAFA had no accompanying increase in resources for the federal judiciary to deal with "an increased caseload and substantially more of these potentially complex cases. …Single federal judges are now expected to do the work of multiple state court judges (and in the same amount of time.)"

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[10] "Joint Statement of Three Justice Organizations on Sequestration Cuts to Courts," http://www.justice.org/cps/rde/xbcr/justice/sequestration_statement_AAJ.pdf.
[11] Todd Ruger, "Sequestration outlook bleak for federal courts," *National Law Journal*, March 8, 2013.
[12] Michael L. Stern, "Fewer Courts, Less Justice," *Los Angeles Times*, December 7, 2012, http://www.latimes.com/news/opinion/commentary/la-oe-stern-l.a.-courts-justice-20121207,0,541449.story.
[13] Testimony of Thomas M. Sobol, Partner, Hagens Berman Sobol Shapiro LLP, Subcommittee on the Constitution of the Committee on the Judiciary, U.S. House of Representatives, "Class Actions Seven Years After the Class Action Fairness Act," June 1, 2012, http://judiciary.house.gov/hearings/Hearings%202012/Sobol%2006012012.pdf.

And given the fact that these federal judges are "hamstrung by the increased attention to state law that these cases require,"[14] with no guidance on how to proceed with multiple state laws, it is no surprise they are reluctant to grant class certification. As a result, "the denial of access to justice is not based on the merits of the case but on a technical procedural issue under the Federal Rules of Civil Procedure – manageability."[15] Sobol testified,

> Worse yet, these certification refusals deny American citizens their Constitutional guarantee to a day in court and the opportunity to have their claims adjudicated. If consumers must band together in a class action to seek redress for their injuries, because any single individual's claim is too small to justify the costs of litigation, and if such class actions can only proceed in federal courts that will not certify their claims, the courthouse doors effectively close, leaving consumers with no remedy.[16]

SUPREME COURT CASES

Continuing on the "no remedy" theme, I will now briefly address recent U.S. Supreme Court decisions that have not only magnified CAFA's impact but also had a dramatic impact on the rights of those who have been violated or harmed. So far, Congress has failed to address any of them. I will begin with a brief discussion of forced arbitration and class action bans.

In *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1748 (2011), the Supreme Court held that the Federal Arbitration Act of 1924 ("FAA") allows corporations to ban class actions and force consumers into a corporate-designed system of forced arbitration. The Court held that even when an existing state law protects individuals from abusive forced arbitration clauses, the FAA trumps these state laws.

The following are just a few of the problems faced by consumers who are forced into arbitration: Arbitrators are often on contract with the businesses against which a claim is brought. Often the company, not the victim, is allowed to choose the arbitrator. This creates inherent bias and self-interest on the part of the arbitrator – the arbitrator is motivated to rule in a way that will attract future company business. At the same time, arbitration companies have a financial incentive to side with corporate repeat players who generate most of the cases they handle. Arbitrators are also not required to have any legal training and they need not follow the law. Court rules of evidence and procedure, which tend to neutralize imbalances between the parties in court, do not apply. There is limited discovery, making it is much more difficult for individuals to have access to important documents that may help their claim. Arbitration proceedings are secretive. Their decisions are still enforceable with the full weight of the law even though they may be legally incorrect. This is especially disturbing since these decisions are binding. Often victims must split the sizeable costs of arbitration with the defense. Even if the defense handles the costs, this

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[14] *Ibid.*
[15] *Ibid.*
[16] *Ibid.*

still gives them the ability to "freeze" a proceeding in the rare situation where it seems the arbitrator is moving against them.[17]

But as noted by Public Justice in recent comments to the Bureau of Consumer Financial Protection, the abusive process – while horrible – is "comparatively less significant an issue than the huge number of cases that have been erased."[18] In other words, "The principal effect of forced arbitration is to wipe away claims,"[19] a problem made exponentially worse by the class action ban upheld by the Court in *Concepcion*. Last week, Public Citizen updated a 2012 study[20] and found that, since *Concepcion*, over 100 potential class actions have been dismissed.[21] However, the numbers are likely much higher than that since Public Citizen only counted cases where a posted opinion appeared in Westlaw's database. Many dismissed cases would not show up there. As explained by Public Justice,[22]

> We are familiar with a number of cases where many thousands of consumers' legal claims were tossed out by courts, without considering the legal or factual merits of the claims, as a consequence of the new legal rule invented by the Supreme Court in the *Concepcion* decision, and know that all or nearly all of the class members claims were not pursued. The claims simply disappeared....

And in its most recent *Workplace Class Action Litigation Report*, the class action defense firm Seyfarth Shaw found that *Concepcion* had already been cited in 325 rulings.[23]

Of course, this result was not unexpected – even by the Court. Noted Public Citizen,

> Justice Antonin Scalia acknowledged the dissent's claim that "class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system." ... In his dissenting opinion in *Concepcion*, Justice Stephen Breyer, writing for four Justices, described the consequences of the Court's decision using the example of a case in which a company cheated 17 million people out of $30 each. "The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as

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[17] *See, e.g.*, Public Justice Comments to Bureau of Consumer Financial Protection In Response to Request for Information for Study of Pre-Dispute Arbitration Agreements, Docket No. CFPB-2012-0017, June 23, 2012, http://publicjustice.net/sites/default/files/downloads/PublicJusticeCommentsToCFPB_ReMandatoryArbitration_Jun2012.pdf.

[18] *Ibid.*

[19] *Ibid.*

[20] Public Citizen and National Association of Consumer Advocates, *Justice Denied One Year Later: The Harms to Consumers from the Supreme Court's Concepcion Decision Are Plainly Evident* (April 2012), http://www.citizen.org/documents/concepcion-anniversary-justice-denied-report.pdf.

[21] Public Citizen, "During National Consumer Protection Week, Consumer Advocates Warn About Harms of Forced Arbitration," March 7, 2013, http://www.citizen.org/pressroom/pressroomredirect.cfm?ID=3830.

[22] Public Justice Comments to Bureau of Consumer Financial Protection In Response to Request for Information for Study of Pre-Dispute Arbitration Agreements, Docket No. CFPB-2012-0017, June 23, 2012, http://publicjustice.net/sites/default/files/downloads/PublicJusticeCommentsToCFPB_ReMandatoryArbitration_Jun2012.pdf.

[23] Seyfarth Shaw LLP, *Ninth Annual Workplace Class Action Litigation Report* (January 2013), http://www.seyfarth.com/dir_docs/publications/CAR2013preview.pdf.

> only a lunatic or a fanatic sues for $30," Justice Breyer wrote, quoting Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit.[24]

The case *Wal-Mart Stores, Inc. v. Dukes*, 131 S.Ct. 2541 (2011), seems to be having an analogous impact on employment discrimination class actions. This case was brought on behalf of more than 1.5 million women who suffered similar discrimination at Wal-Mart. The Court basically ruled that the class was too big. Writes *Reuters*:

> Since the Dukes decision, defendants in a variety of class actions have flooded courts with motions challenging discrimination and violation of labor laws. The defendants have argued that claims made by plaintiffs lacked commonality. Some defendants have also used the ruling as a tool to have class claims dismissed even before the issue of class certification is addressed.[25]

In its most recent *Workplace Class Action Litigation Report*, the class action defense firm Seyfarth Shaw wrote:[26]

> As of the close of [2012], *Wal-Mart* had been cited a total of 541 times in lower court rulings, a remarkable figure for a decision rendered in June of 2011. ... *Wal-Mart* caused both federal and state courts to conduct a wholesale review of the propriety of previous class certification orders in pending cases, prompted defendants to file new rounds of motions for decertification based on *Wal-Mart* to attack all sorts of class theories (and not just those modeled after the nationwide class claims rejected in *Wal-Mart*), and reverberated in case law rulings on a myriad of Rule 23-related issues. ... Simply stated, *Wal-Mart* aided employers to defeat, fracture, and/or devalue employment discrimination class actions, and resulted in fewer settlements at lower amounts.

Even more ominous, employers have yet to take advantage of the class action ban allowed by *Concepcion*. That will change soon enough. As Seyfarth Shaw notes:

> Although mandatory arbitration and class action waiver provisions are already common in retail contracts, the next major step is likely to be their broader introduction into employment contracts (where only collective bargaining agreements, at least in unionized companies, may impede their use).[27]

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[24] Public Citizen and National Association of Consumer Advocates, *Justice Denied One Year Later: The Harms to Consumers from the Supreme Court's Concepcion Decision Are Plainly Evident* (April 2012), http://www.citizen.org/documents/concepcion-anniversary-justice-denied-report.pdf.
[25] Andrew Longstreth, "Wal-Mart v. Dukes shakes up employment class actions," *Thomson Reuters News and Insight*, January 9, 2012, http://newsandinsight.thomsonreuters.com/Legal/News/2012/01_-_January/Wal-Mart_v__Dukes_shakes_up_employment_class_actions/.
[26] Seyfarth Shaw LLP, *Ninth Annual Workplace Class Action Litigation Report* (January 2013), http://www.seyfarth.com/dir_docs/publications/CAR2013preview.pdf.
[27] *Ibid.*

Yet these are not the only Supreme Court cases that have drastically limited plaintiffs' rights, including additional arbitration cases, over the past few years. The following are a few additional highlights, listed chronologically:

- *Stoneridge Investment Partners v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008). Here, the Supreme Court ruled that investment banks, lawyers, accountants, credit rating bureaus or other so-called "secondary actors" who knowingly help a public company deceive investors cannot be liable for the fraud if they did not make a material misrepresentation to shareholders. Again, the impact was immediate. In a March 2009 ruling, Judge Gerald Lynch (S.D.N.Y.) said, "It is perhaps dismaying that participants in a fraudulent scheme who may even have committed criminal acts are not answerable in damages to the victims of the fraud. …This [law] may be ripe for legislative re-examination."[28] So far, there has been no such legislative re-examination.

- *Riegel v. Medtronic*, 128 S. Ct. 999 (2008). In this case, the Court ruled that anyone injured by a Class III medical device, like a heart defibrillator or implant, has no remedy in court. The impact of this decision was immediate. In January 2009, a federal court dismissed over 1,000 lawsuits brought by victims of a Medtronic defibrillator flaw involving a defective Sprint Fidelis lead (the wire that connects the heart to the defibrillator) that fractured causing electrical shocks in patients. The judge said, "The court recognizes that at least some plaintiffs have suffered injuries from using Sprint Fidelis leads, and the court is not unsympathetic to their plight [but] the court simply cannot provide a remedy."[29] Congress can fix this decision but so far has refused.

- *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), preceded by ***Bell Atlantic Co. v. Twombly***, 127 S. Ct. 1955 (2007). Under these decisions, cases that fail to meet stringent new pleading standards are dismissed, even if parties have not been able to access any of the documents or conduct the discovery necessary to garner the information they need. University of Houston Law Professor Lonny Hoffman analyzed data collected by the Federal Judicial Center and found that, since ***Iqbal***, plaintiffs have been twice as likely to face a motion to dismiss and more likely "in every case category examined that a motion to dismiss would be granted…."[30] In employment discrimination and civil rights cases, for example, "plaintiffs were negatively affected in at least one out of every four such cases."[31]

- *Stolt-Nielsen S.A. v. Animal Fees International Corp.*, 130 S. Ct. 1758 (2010). The Court ruled that "a party may not be compelled under the [Federal Arbitration Act of 1924] to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so. … All of this, supposedly, is based on the FAA and is what Congress intended when it passed the Act in 1924. If you like, you can think of it as a special

[28] *In re Refco, Inc. Securities Litigation*, 2009 WL 724378 (S.D.N.Y., March 17, 2009).
[29] Janet Moore, "Judge Dismisses Suits Over Fidelis Lead," *Minneapolis Star Tribune*, January 6, 2009, http://www.startribune.com/business/37183974.html.
[30] Lonny Hoffman, "Rulemaking in the Age of *Twombly* and *Iqbal*," *U.C. Davis L. Rev.* (forthcoming 2013), http://ssrn.com/abstract=2123325.
[31] *Ibid.*

clear-statement rule of federal common law – a rule that elevates hostility to class actions above ordinary principles of contract interpretation…."[32]

- *Rent-A-Center v. Jackson*, 130 S.Ct. 2772 (2010). Until this decision, "consumers and employees had the right, under Section 2 of the Federal Arbitration Act, to go to court and ask a judge to find an arbitration agreement unconscionable or unfair and therefore unenforceable."[33] This ruling left many challenges even to the very worst abuses "entirely in the hands of arbitrators themselves,"[34] so that companies can "impose one-sided terms or select clearly biased arbitrators with close ties to the company, secure in the knowledge that any challenge to the fairness of arbitration will be decided by the arbitrator whose very authority comes from the challenged arbitration agreement. … Justice Stevens pointed out that neither party had urged the rule adopted by the Court and characterized the Court's reasoning as 'fantastic.'"[35]

- *Pliva v. Mensing*, 131 S.Ct. 2567 (2011). In the last Congress, U.S. Senate Judiciary Chair Patrick Leahy introduced the "Patient Safety and Generic Labeling Improvement Act" to try to address this decision. He explained the impact: "If a consumer takes the brand-name version of drug, she can sue the manufacturer for inadequate warnings. If the pharmacy happens to give her the generic version, she will not be compensated for her injuries. The result is a two-track system that penalizes consumers of generic drugs – even though many consumers have no control over which drug they take, because state law and their health insurance plan require them to take generics if they are available."[36] So far, Congress has taken no action to fix this decision, and the Court is now poised to extend this reasoning to all cases involving generic drug defects.[37]

Finally, the upcoming Supreme Court case, *American Express v. Italian Colors Restaurant*, should give individuals and small businesses grave concern. Past Supreme Court decisions have held that arbitration with "prohibitive costs" cannot prevent victims with federal statutory claims from effectively vindicating their rights. In *American Express*, the plaintiffs – small business merchants – are claiming exactly this. Their merchant contracts with AmEx contain forced arbitration clauses and class action bans. They argue that forcing them to arbitrate their anti-trust claims individually would be so prohibitively expensive that they could not vindicate their federal rights. However, the Court majority seems to be moving in AmEx's favor.

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[32] Deepak Gupta, "Supreme Court Decides Stolt-Nielsen: No Class Arbitration Where Clause is 'Silent,'" *Public Citizen Consumer Law & Policy Blog*, April 27, 2010, http://pubcit.typepad.com/clpblog/2010/04/supreme-court-decides-stoltneilsen-no-class-arbitration-where-clause-is-silent.html.

[33] "Supreme Court Decides Rent-a-Center v. Jackson: Companies Can Delegate Unconscionability Challenges to the Arbitrator," *Public Citizen Consumer Law & Policy Blog*, June 21, 2010, http://pubcit.typepad.com/clpblog/2010/06/supreme-court-decides-rentacenter-v-jackson-companies-can-delegate-unconscionability-challenges-to-t.html.

[34] *Ibid.*

[35] *Ibid.*

[36] Office of U.S. Senator Patrick Leahy, "Leahy To Introduce Bill To Protect Consumers Who Take Generic Drugs," March 26, 2012, http://www.leahy.senate.gov/press/leahy-to-introduce-bill-to-protect-consumers-who-take-generic-drugs.

[37] Katie Thomas, "Justice to Take Up Case on Generic Drug Makers' Liability," *New York Times*, March 4, 2013, http://www.nytimes.com/2013/03/05/business/justices-to-take-up-case-on-generic-drug-makers-liability.html.

SMALL BUSINESSES

Lobbyists for groups like the National Federation of Independent Businesses (NFIB) seem so intent on joining with the U.S. Chamber of Commerce to push for so-called "tort reforms" that they have disconnected from developments that could really harm their members, like the *AmEx* case. In fact, while NFIB lobbyists have made "tort reform" a top legislative priority, survey after survey shows that their members actually do not care about "lawsuits" or "tort reform," and are rather concerned about far more pressing issues for their own survival and growth.[38] Small businesses virtually always put "lawsuits" or "liability" at the bottom of their list of concerns, if they mention them at all. Here is what we know about the concerns of small businesses:

National Federation of Independent Businesses (NFIB)

- NFIB's latest survey *Small Business Problems & Priorities* (August 2012) ranks "Costs and Frequency of Lawsuits/Threatened Lawsuits" at #71 out of 75 issues, a lower rank than how to use Twitter.[39] In looking only at concerns about costs as a problem cluster, "Costs and Frequency of Lawsuits/Threatened Lawsuits" ranked *last* among cost issues.[40] In fact, NFIB calls this issue, one of the "10 least severe problems for small-business owners of the 75 business problems assessed…."[41]

National Small Business Association (NSBA)

- In December 2012, NSBA released the results of its Small Business Congress priority vote. Neither "lawsuits" nor "tort reform" are mentioned.[42]

Small Business & Entrepreneurship Council (SBE)

- Similarly, SBE's January 2013 list of 10 small business issues to watch in 2013 does not include "lawsuits" or "tort reform."[43]

CONCLUSION

The topic of this hearing is "Examination of Litigation Abuse." For the last 30 years, corporations and their insurers have been relentlessly attacking the civil justice system with one

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[38] National Federation of Independent Businesses, *Small Business Problems and Priorities* (August 2012) at 14, 35, 36, http://www.nfib.com/Portals/0/PDF/AllUsers/research/studies/small-business-problems-priorities-2012-nfib.pdf.
[39] *Id.* at 14.
[40] *Id.* at 19.
[41] *Id.* at 5.
[42] National Small Business Association, "NSBA Members Vote on Priorities for 113th Congress," December 5, 2012, http://www.nsba.biz/?p=4688; National Small Business Association, "NSBA Members Vote on Priorities for 113th Congress," December 5, 2012, http://www.prnewswire.com/news-releases/nsba-members-vote-on-priorities-for-113th-congress-182221211.html.
[43] Small Business & Entrepreneurship Council, "Ten Small Business Issues To Watch In 2013," http://www.sbecouncil.org/2013/01/22/ten-small-business-issues-to-watch-in-2013/.

goal in mind – to limit their liability exposure by stripping Americans of their legal rights. This is one way that I would define "litigation abuse." Another way I would define it is having corporations engage in discovery abuse, as well as immunize themselves from wrongdoing with forced arbitration clauses and class action bans. I would also define it this way: a company steals or cheats people out of millions of dollars (as found by a court) and then expects never to held accountable for this because its customers are dead or cannot be found. Eliminating the *cy pres* mechanism is simply another tactic to weaken the class action system, which is already in freefall thanks to recent U.S. Supreme Court decisions. And I would also define "litigation abuse" as the DC-based U.S. Chamber of Commerce dumping millions of dollars into local judicial races for the purpose of electing judges who are answerable to them and then attacking attorneys who try to protect the rights of their clients and maximize their chance of success (just as defendants do), while having to navigate that landscape. The ultimate irony here is that the federal Class Action Fairness Act of 2005 is "the epitome of forum-shopping [since] if defendants do not want to be in state court, they no longer have to be."[44]

I thank you for your time and would be happy to answer any questions.

[44] Testimony of Thomas M. Sobol, Partner, Hagens Berman Sobol Shapiro LLP, Subcommittee on the Constitution of the Committee on the Judiciary, U.S. House of Representatives, "Class Actions Seven Years After the Class Action Fairness Act" June 1, 2012, http://judiciary.house.gov/hearings/Hearings%202012/Sobol%2006012012.pdf.

Mr. FRANKS. Thank you, Ms. Doroshow.

I will now recognize our fourth witness, Mr. Beisner.

TESTIMONY OF JOHN H. BEISNER, ON BEHALF OF THE U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

Mr. BEISNER. Thank you, Mr. Chairman, and Members of the Subcommittee, for inviting me to appear here today.

I am appearing on behalf of the U.S. Chamber Institute for Legal Reform, which is the only national legal reform advocate to approach reform comprehensively by working to improve not only the law, but also the legal climate.

Over the last several years, significant progress has been made in addressing certain forms of litigation abuse in the United States, both at the Federal and State court level. The most significant of these is the Class Action Fairness Act of 2005, or CAFA, which has virtually eliminated so-called magnet State courts that were once a haven for meritless and abusive class-action lawsuits.

But more work is needed. The United States is experiencing far too much litigation abuse. It is undermining our economy and sullying the reputation of our legal system.

I would like to focus on three areas ripe for abuse: class actions, State attorney general enforcement of Federal law, and third-party litigation financing.

Let me start with class actions. Although CAFA has vastly improved the civil justice landscape, the threat of abusive class actions has not been completely extinguished, for several reasons.

First, some Federal courts have undermined the effectiveness of CAFA by making it far more difficult to remove cases to Federal court than Congress had intended. At least one of the issues I am referencing has worked its way up to the Supreme Court in the *Standard Fire Insurance Company v. Knowles* case. The Supreme Court will be deciding whether a named plaintiff can avoid removal under CAFA by stipulating that she does not seek to recover more than $5 million on behalf of the absent class members. If in Knowles, the Supreme Court condones the practice of using stipulations to defeat CAFA jurisdiction, that ruling would be a blow for civil justice.

The second problem is that some Federal courts have ignored the Supreme Court's ruling in the *Walmart Stores v. Dukes* case, which permits certification of classes only after a rigorous analysis to ensure that plaintiffs' claims are really susceptible to being proved on a classwide basis.

As a result, even in some Federal courts, frivolous class actions are proceeding.

Another problem affecting Federal class-action litigation is increasing reliance on cy pres settlements, which were mentioned earlier. Now these may seem like a good deal by ensuring that some money in a settlement goes to a good cause. But in reality, cy pres is a way for class lawyers to justify big fees without providing any real benefits to class members.

Another area that warrants scrutiny is the proliferation of arrangements under which State attorneys general hire outside counsel on a contingency fee basis to represent the State in civil litigation. This problem threatens to worsen as more Federal statutes give State attorneys general authority to enforce Federal laws. And I am talking about statutes such as the Truth in Lending Act, HIPAA, the Dodd-Frank statute, and the Consumer Products Safety Improvement Act of 2008.

Contingency fee contracts between AGs and private counsel can create unseemly liaisons between public enforcement officials and private profit-motivated lawyers. They also threaten to violate the constitutional rights of defendants who find themselves the targets of lawsuits that combine the political power of the State and the financial power of the plaintiffs' bar.

To avoid these results, Congress should consider enacting legislation that prohibits State AGs from retaining contingency fee counsel to enforce Federal law. Such legislation would promote the integrity of enforcement proceedings and safeguard the constitutional rights of defendants.

Finally, I want to address one more looming litigation abuse: third-party litigation financing. For those unfamiliar with this practice, TPLF is the practice of investing in lawsuits. And if that concept makes you uncomfortable, your instincts are right.

This has the potential to dramatically adversely affect our civil justice system by increasing the filing of questionable claims, diminishing the ability of individuals to have a say in their own lawsuits, to prolong litigation, to drive up the return on investments for the investors in such litigation, and to compromise the critical attorney-client relationship.

In my written testimony, I outline a number of proposals for addressing this issue.

Again, I appreciate the opportunity to speak this morning and would be happy to answer any questions.

[The prepared statement of Mr. Beisner follows:]

<u>Testimony of John H. Beisner[1]</u>
<u>On Behalf of the U.S. Chamber Institute for Legal Reform</u>
<u>Before the Subcommittee on the Constitution and Civil Justice</u>
<u>of the Committee on the Judiciary</u>
<u>United States House of Representatives</u>

<u>Examination of Litigation Abuses</u>
<u>March 13, 2013</u>

Good morning Chairman Franks, Ranking Member Nadler and Members of the Subcommittee. Thank you for inviting me to testify today about litigation abuses in the United States and what can be done to address them.

Today, I am testifying on behalf of the U.S. Chamber Institute for Legal Reform ("ILR"). The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. The Chamber founded ILR in 1998 to address the country's litigation explosion. ILR is the only national legal reform advocate to approach reform comprehensively, by working to improve not only the law, but also the legal climate.

In recent years, significant progress has been made in addressing certain forms of litigation abuse in the United States, both at the federal and state court levels. In particular, enactment of the Class Action Fairness Act of 2005 ("CAFA") improved federal class action practice by extinguishing magnet state court jurisdictions that were once a haven for meritless and abusive class action lawsuits. CAFA has helped ensure that before they are allowed to proceed, most interstate class actions are subject to a "rigorous analysis" under Fed. R. Civ. P. 23, as mandated by the U.S. Supreme Court, and it has reduced the frequency of class settlements that benefit attorneys at the expense of consumers. But more work is needed. The U.S. still has far too much litigation abuse, and it is undermining our economy and sullying the reputation of our legal system.

My testimony today will focus on the road ahead for class actions; the risks posed by state attorney general enforcement of federal laws; and the threats presented by third-party litigation financing activity.

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I. <u>DESPITE CAFA'S SUCCESSES, ABUSIVE CLASS ACTION PRACTICES CONTINUE.</u>

In enacting CAFA, Congress sought to accomplish three specific goals: (1) to "assure fair and prompt recoveries for class members with legitimate claims"; (2) to "restore the intent of the framers of the United States Constitution by providing for Federal court consideration of interstate cases of national importance under diversity jurisdiction"; and (3) to "benefit society by encouraging innovation and lowering consumer prices."[2] CAFA has achieved each of these goals and more. Most notably, CAFA has drawn large number of class actions to federal courts that otherwise would have proceeded in "magnet" state courts employing lax class certification standards. CAFA has also helped consumers by requiring greater scrutiny of class action settlements.

While CAFA has undoubtedly contributed to a more equitable civil justice landscape, the engine of our nation's economy continues to be threatened by abusive class action practices. This is due in large part to the fact that some federal courts have not been entirely faithful to Congress's overarching intent that CAFA would expand federal jurisdiction over interstate class actions. In addition, federal courts have not uniformly embraced the Supreme Court's mandate that lawsuits be subjected to a "rigorous analysis" before class certification is granted. Finally, the growing use of *cy pres* in structuring class settlements is a threat to CAFA's goal of ensuring that aggrieved class members directly benefit from the class device.

A. Some Federal Courts Have Not Fully Embraced Congressional Intent When Interpreting CAFA.

Although there can be no dispute that CAFA has mitigated a number of abusive class action practices, the full Congressional intent of that law has not been embraced consistently by all federal courts. As a result, some defendants have been forced to defend against putative class actions in state courts that regularly employ class action standards far less rigorous than those observed by our federal courts.

First, some federal courts have thwarted CAFA's purpose of broadly expanding federal jurisdiction over interstate class actions by imposing a "legal certainty" requirement for satisfying CAFA's amount-in-controversy threshold, allowing plaintiffs to stipulate that they will not seek $5 million in damages; and/or refusing to consider declarations submitted in support of removal notices.

Although Congress made it clear that in cases where "a Federal court is uncertain . . . the court should err in favor of exercising jurisdiction over the case,"[3] some courts (including the

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2 Pub. L. 109-2, § 2(b)(1)-(3), 119 Stat. 5.

3 151 Cong. Rec. 727 (2005) (statement of Rep. Jim Sensenbrenner); *see also* Pub.L. 109-2, § 2(b)(2), 119 Stat. 5 (2005) (stating that one purpose of CAFA is to "restore the intent of the framers of the United States Constitution by providing for Federal court consideration of interstate cases of national importance under diversity jurisdiction"); *see also* Hunter Twiford, III, et al., *CAFA's New 'Minimal Diversity' Standard for Interstate Class Actions Creates a Presumption That Jurisdiction Exists, with the Burden of Proof Assigned to the Party Opposing Jurisdiction*, 25 Miss. C. L. Rev. 7, 53 (2005) (highlighting that "CAFA Section 2, 'Findings and Purposes,' . . .

(cont'd)

Third and Ninth Circuits) have disregarded this presumption in favor of imposing a heightened "legal certainty" obligation on defendants with respect to the amount-in-controversy requirement.[4] Under this standard, the amount in controversy stated in the complaint controls so long as it is claimed in good faith.[5] In other words, when a plaintiff disclaims that the amount in controversy exceeds $5 million, the defendant must prove with "legal certainty" that the amount in controversy exceeds $5 million. The rationale underlying these decisions is the concept that a plaintiff is the master of his complaint. But in enacting CAFA, Congress made clear that such axioms should not supply a basis for excluding class actions from federal jurisdiction.

Most other circuits have adopted a more appropriate "preponderance of the evidence" test for establishing jurisdiction with respect to the amount in controversy under CAFA.[6] Under this standard, a defendant removing a class action from state to federal court need only show that the amount in controversy "'more likely than not' exceeds the jurisdictional threshold."[7]

A similar question of CAFA interpretation is currently before the Supreme Court in *Standard Fire Insurance Co. v. Knowles*, No. 11-1450, which will likely be decided before the end of the Court's 2013 term. The key question presented in *Standard Fire* is whether a named plaintiff may avoid removal under CAFA by stipulating that she does not seek to recover more than $5 million on behalf of the absent class members. In *Knowles*, the plaintiff filed a putative class action in state court against Standard Fire, alleging breach of contract arising out of the defendant's alleged underpayment of claims for loss or damage to real property.[8] Standard Fire removed the class action to federal court under CAFA, arguing, *inter alia*, that the plaintiff lacked the authority to limit the recovery that would bind the absent class members. The district court remanded the action on the ground that the plaintiff had signed a stipulation limiting the amount of damages to just below the jurisdictional minimum set forth by CAFA.[9] In so doing, the court rejected the defendant's argument that plaintiff sought "to circumvent CAFA and receive an award in excess of the $5 million threshold" imposed by CAFA.[10] The Eighth Circuit

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[reflects] the strong congressional policy seeking to limit class-action abuses in the state courts by allowing more interstate class actions to be maintained in the federal courts").

4 *See Campbell v. Vitran Express, Inc.*, 471 F. App'x 646, 649 (9th Cir. 2012); *Morgan v. Gay*, 471 F.3d 469, 474 (3d Cir. 2006).

5 Kalee DiFazio, *CAFA's Impact on Forum Shopping and the Manipulation of the Civil Justice System*, 17 Suffolk J. Trial & App. Adv. 133, 149 (2012).

6 *See, e.g.*, *Frederick v. Hartford Underwriters Ins. Co.*, 683 F.3d 1242, 1246 (10th Cir. 2012); *Hargis v. Access Capital Funding, LLC*, 674 F.3d 783, 789 (8th Cir. 2012); *Blomberg v. Serv. Corp. Int'l*, 639 F.3d 761, 763 (7th Cir. 2011); *Berniard v. Dow Chem. Co.*, 481 F. App'x 859, 862 (5th Cir. 2010).

7 DiFazio, *supra* note 5, at 147.

8 *Knowles v. Std. Fire Ins. Co.*, No. 4:11-cv-04044, 2011 U.S. Dist. LEXIS 139077 (W.D. Ark. Dec. 2, 2011), *cert. granted*, 133 S. Ct. 90 (2012).

9 *Id.* at *10-11.

10 *Id.* at *11.

refused to grant an interlocutory appeal of the District Court's ruling, but the Supreme Court granted certiorari.[11]

By contrast, some courts have taken the opposite approach to this question, rejecting the stipulation practice as a means to avoid federal jurisdiction. For example, in *Smith v. Nationwide Property & Casualty Insurance Co.*, the Sixth Circuit explained that "[a] disclaimer in a complaint regarding the amount of recoverable damages does ***not*** preclude a defendant from removing the matter to federal court upon a demonstration that damages are 'more likely than not' to 'meet the amount in controversy requirement.'"[12] Several other district courts have also rejected such damages stipulations in the CAFA context.[13]

If the Supreme Court in *Knowles* condones the practice of using stipulations to defeat CAFA jurisdiction, plaintiffs' lawyers will be able to evade federal jurisdiction under CAFA with great ease. Such a result would allow class counsel to sell out the interests of the putative class simply to ensure that they can litigate in state court forums that are hostile to out-of-state defendants. It would also represent an end-run around Congress's clear intent behind CAFA, which was enacted to keep interstate class actions out of these magnet state courts.

Yet another related question that has arisen in CAFA removals is the propriety of relying on extrinsic documents to demonstrate jurisdiction. For example, in *Thomas v. Bank of America Corp.*, the Eleventh Circuit determined that a defendant seeking to remove a putative mass action to federal court could not rely on extrinsic evidence where "the complaint provided no information indicating the amount in controversy or the number of individuals in the alternative classes."[14] The *per curiam* ruling suggests that a defendant may not be able to supplement its notice of removal with evidence outside the complaint, at least in "mass action" cases where the complaint is silent regarding the amount in controversy or the number of individuals encompassed by the mass action.

The Ninth Circuit has followed a similar path. In *Coleman v. Estes Express Lines, Inc.*, the plaintiff commenced a class action in California state court seeking recovery of unpaid overtime and other wages under California law. One of the defendants removed the case to federal court, and plaintiff moved to remand under the local-controversy exception.[15] In support of removal, the defendant submitted a declaration that it did not have the funds to satisfy any

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11 Notably, the Eighth Circuit made its views on this issue clear in another case, *Rolwing v. Nestle Holdings, Inc.*, where it held that a "stipulation limiting damages . . . to an amount not exceeding $5 million ***can*** be used to defeat CAFA jurisdiction." 666 F.3d 1069, 1072 (8th Cir. 2012) (emphasis added) (affirming grant of remand in shareholder suit).

12 505 F.3d 401, 407 (6th Cir. 2007) (citations omitted, emphasis added).

13 *See, e.g.*, *Proffitt v. Abbott Labs.*, No. 2:08-CV-149, 2008 U.S. Dist. LEXIS 72470, at *4-5 (E.D. Tenn. Sept. 23, 2008) ("[A] disclaimer in a complaint regarding the amount of recoverable damages does not preclude a defendant from removing the matter to federal court upon a demonstration that damages are 'more likely than not' to 'meet the amount in controversy requirement[.]'") (citations omitted).

14 570 F.3d 1280, 1282-83 (11th Cir. 2009) (per curiam).

15 631 F.3d 1010, 1013 (9th Cir. 2011).

judgment obtained by the plaintiff.[16] The district court refused to consider this extrinsic evidence and remanded the action. The Court of Appeals affirmed, holding that any inquiry regarding the local-controversy exception must be limited strictly to the complaint.[17] Notably, other district courts have relied on *Coleman* in refusing to consider extrinsic evidence in assessing the propriety of removal under CAFA.[18]

Second, a few courts have interpreted CAFA's "home-state" exception much more liberally than Congress intended. These courts have applied an expansive approach to the "home-state" exception, which has generated mounting state court class action activity in certain jurisdictions. Under the home-state-controversy exception, "[a] district court shall decline to exercise jurisdiction [where] . . . two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are citizens of the State in which the action was originally filed."[19] In a class action in which greater than one-third but less than two-thirds of the class are citizens of the forum state, the district court "***may*** . . . decline to exercise jurisdiction" "in the interests of justice and looking at the totality of the circumstances."[20] Most courts have appropriately recognized that "the plaintiff has the burden of persuasion on the question whether the home-state . . . exception[] appl[ies]."[21] But while Congress intended this exception to be construed "narrowly" and in favor of exercising diversity jurisdiction, not all courts have adhered to Congress's clear intent.

Hirschbach v. NVE Bank[22] is illustrative. In that case, a federal district court *sua sponte* remanded an action to state court under CAFA's home-state exception. The case was a consumer-fraud class action filed initially in New Jersey state court, alleging that the defendants, NVE Bank (a New Jersey state-chartered bank) and its holding company, issued certificates of deposit to the class members at competitive interest rates and then fraudulently applied below-market interest rates to renewed certificates.[23] Plaintiff defined the class as "all persons who invested in a CD issued by NVE Bank at competitive market rates and renewed at least once by NVE Bank after the initial maturity date and have received or are receiving interest on their renewed CD at below competitive market rates."[24] NVE Bank removed the case to federal court, asserting federal-question and CAFA jurisdiction. Even though the plaintiff did not file a motion to remand, the district court remanded the action to state court *sua sponte*.

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16 *Id.* at 1014.

17 *Id.* at 1020.

18 *See, e.g.*, *Smith v. Kawailoa Dev. LLP*, No. 11-00350 JMS/BMK, 2011 U.S. Dist. LEXIS 147955, at *8 (D. Haw. Dec. 22, 2011) (remanding action, relying on "*Coleman's* clear explanation that a district court cannot consider extrinsic evidence").

19 28 U.S.C. § 1332(d)(4)(B).

20 28 U.S.C. § 1332(d)(3) (emphasis added).

21 *See Hart v. FedEx Ground Package Sys.*, 457 F.3d 675, 681 (7th Cir. 2006).

22 496 F. Supp. 2d 451 (D.N.J. 2007).

23 *Id.* at 452-53.

24 *Id.*

The court initially found that all of the *prima facie* CAFA removal elements were met – i.e., that the amount in controversy was present, that there was minimal diversity between the putative class and the defendants, and that the putative class contained at least 100 members.[25] However, instead of ending the inquiry there – after all, the plaintiff had never contested defendant's removal – the court proceeded to examine whether the case fell within the home-state exception. The court remanded the action under the discretionary prong of the home-state exception after finding that at least one-third of the class consisted of New Jersey residents.[26] The court concluded that the home-state exception was satisfied because, *inter alia*, the case involved a purely state-law claim.[27] This decision is contrary to CAFA since its very purpose was to allow removal of cases in which federal claims were not asserted. Moreover, the *Hirschbach* court disregarded ample caselaw holding that the burden of establishing a CAFA exception rests with the plaintiff. The ruling thus sets a troubling precedent for *sua sponte* remands of class actions that otherwise satisfy CAFA's minimal-diversity and amount-in-controversy requirements.[28]

The home-state exception was included in CAFA in order to ensure that only truly local class actions could be litigated in state court. However, as the rulings summarized above demonstrate, some courts have taken this exception too far, allowing plaintiffs to circumvent CAFA and maintain abusive class actions in state court.

Third, some plaintiffs' counsel have also pursued abusive litigation tactics with respect to another category of cases removable under CAFA: "mass actions."[29] According to CAFA's legislative history, "[m]ass action cases function very much like class actions" and "are simply class actions in disguise. They involve a lot of people who want their claims adjudicated on an aggregate basis, and they often produce the same abuses as class actions. In fact, sometimes the abuses are even worse because the lawyers seek to join claims that have little to do with each other and confuse a jury into awarding millions of dollars to individuals who have suffered no real injury."[30] Therefore, not only does CAFA expand federal jurisdiction over class actions, but it also provides for federal jurisdiction over mass actions, which are defined as "any civil action . . . in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact . . . ."[31]

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25 *Id.* at 458.

26 *Id.* at 460-61.

27 *Id.* at 461.

28 *See also Bey v. Solarworld Indus. Am.*, No. 3:11-cv-1555-SI, 2012 U.S. Dist. LEXIS 181717, at *12 (D. Or. Dec. 26, 2012) (declining to exercise federal jurisdiction under home-state exception *sua sponte* because, *inter alia*, "[t]he complaint pleads only Oregon law").

29 *Tanoh v. Dow Chem. Co.*, 561 F.3d 945, 956 (9th Cir. 2009).

30 S. Rep. 109-14, at 16-17.

31 28 U.S.C. § 1332(d)(11)(B)(i).

CAFA's mass action provision represents a "[c]ongressional attempt to address notorious joinder abuses at the state level."[32] Congress sought to define the term "class action" broadly to avoid "jurisdictional gamesmanship"; hence, it follows perforce that the "potentially more-abusive mass actions should be construed just as liberally."[33] However, not all courts have embraced this line of reasoning. Instead, in applying the "mass action" provision of CAFA quite narrowly, several courts have explained that the "removal statute is to be 'strictly construed against removal jurisdiction and any doubt must be resolved in favor of remand.'"[34] As one court recently explained in rejecting removal under the "mass action" provision, "Congress intended to limit the numerosity component of mass actions quite severely[.]"[35]

Some courts have even gone so far as to hold that whether "plaintiffs have deliberately divided their cases in order to avoid the mass action threshold is ***irrelevant***."[36] In *Tanoh v. Dow Chemical Co.*, 561 F.3d 945 (9th Cir. 2009), for example, the Ninth Circuit affirmed a lower court's order remanding the claims of 664 named plaintiffs to state court because the claims did not satisfy CAFA's jurisdictional requirements as a "mass action."[37] There, the 664 plaintiffs asserted tort claims based on their exposure to the defendant's products containing an allegedly toxic chemical in ***seven*** separate lawsuits filed in state court in California.[38] Each lawsuit had fewer than 100 plaintiffs, none of whom appeared as plaintiffs in more than one of the suits. Further, none of the lawsuits asserted class claims.[39] Dow removed the cases to federal court, arguing, *inter alia*, that the seven individual lawsuits taken together constituted a "mass action" under CAFA.[40] The Ninth Circuit rejected Dow's argument, applying a strict interpretation of CAFA's statutory language defining a "mass action."[41] According to the Court of Appeals, the provision creating "mass actions" is a "narrow" one, which applies "only to civil actions in which the 'monetary relief claims of 100 or more persons are proposed to be tried jointly.'"[42]

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32 Anthony Rollo & Gabriel A. Crowson, *Mapping the New Class Action Frontier - A Primer on the Class Action Fairness Act and Amended Federal Rule 23*, 59 Consumer Fin. L.Q. Rep. 11, 14 (2005).

33 *See* Jacob Durling, *Waltzing Through a Loophole: How Parens Patriae Suits Allow Circumvention of the Class Action Fairness Act*, 83 U. Colo. L. Rev. 549, 569 (2012) (citing *Louisiana ex rel. Caldwell v. Allstate Ins. Co.*, 536 F.3d 418, 424 (5th Cir. 2008)).

34 *Barria v. Dole Food Co.*, No. CV 09-213-CAS(VBKX), 2009 WL 689903, at *4 (C.D. Cal. Mar. 9, 2009) (remanding cases; "Nothing in CAFA suggests that plaintiffs, as masters of their complaint, may not 'file multiple actions, each with fewer than 100 plaintiffs, to work within the confines of CAFA to keep their state-law claims in state court.'") (citation omitted).

35 *Gutowski v. McKesson Corp.*, No. C 12-6056 CW, 2013 WL 675540, at *1 (N.D. Cal. Feb. 25, 2013) (granting motion to remand) (internal quotation marks and citation omitted).

36 *Nunn v. Monsanto Co.*, No. 4:11-CV-1657 (CEJ), 2011 U.S. Dist. LEXIS 128375, at *8 (E.D. Mo. Nov. 7, 2011) (emphasis added).

37 561 F.3d 945.

38 *Id.* at 950-51.

39 *Id.*

40 *Id.* at 951.

41 *Id.* at 953-54.

42 *Id.* at 953 (quoting 28 U.S.C. § 1332(d)(11)(B)(i)).

The court reasoned that because "none of the seven state court actions involve[d] the claims of one hundred or more plaintiffs, and neither the parties nor the trial court ha[d] proposed consolidating the actions for trial," the cases did not qualify as a "mass action."[43]

The Third and Seventh Circuits have embraced the Ninth Circuit's approach in *Tanoh*, rejecting similar arguments to those advanced by Dow in that case. For example, in *Abrahamsen v. ConocoPhillips, Co.*, the Third Circuit vacated the dismissal of four separate actions and remanded them to state court, finding that the requirements for a "mass action" under CAFA had not been met.[44] In that case, plaintiffs, totaling 123 persons, brought four separate cases against defendant for injuries they sustained while working on vessels, rigs and platforms for defendant. Relying on *Tanoh*, the Third Circuit reasoned that "[b]ecause each suit includes fewer than one hundred persons, none of Plaintiffs' four suits meets CAFA's definition of a 'mass action' and therefore no suit qualifies for removal jurisdiction."[45] Similarly, in *Anderson v. Bayer Corp.*, the Seventh Circuit denied the defendants' petition for leave to appeal the district court's remand orders on the ground that four "mostly identical complaints in state court" did not satisfy the requirements for a "mass action" under CAFA because none of the cases contained 100 or more plaintiffs.[46] The appellate court rejected defendants' argument that plaintiffs' actions were "a transparent attempt to circumvent CAFA," siding with the Ninth Circuit's view that "[t]he mass action provision gives plaintiffs the choice to file separate actions that do not qualify for CAFA jurisdiction."[47]

B. Some Courts Are Failing To Undertake A "Rigorous Analysis" Of The Rule 23 Prerequisites To Class Certification.

In *Wal-Mart Stores, Inc. v. Dukes*, the Supreme Court reversed an *en banc* ruling of the U.S. Court of Appeals for the Ninth Circuit, putting an end to a sprawling nationwide class action consisting of 1.5 million female Wal-Mart employees who alleged discrimination and sought injunctive relief, declaratory relief and back pay. In its ruling, the Court confirmed that analysis of the class action requirements under Rule 23 must be "rigorous."[48] In reversing the Ninth Circuit's ruling, the Supreme Court explained that "Rule 23 does not set forth a mere pleading standard"; rather, a plaintiff must "prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc."[49]

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43 *Id.*

44 No. 12-CV-1199, 2012 WL 5359530, at *2 (3d Cir. Nov. 1, 2012).

45 *Id.* at *2 n.4 (citing *Tanoh*, 561 F.3d at 950); *see also Rodriguez v. Monsanto Co.*, No. 4:11-CV-01658 AGF, 2011 WL 5245251, at *2-3 (E.D. Mo. Nov. 2, 2011) (remanding 11 cases, each containing fewer than 100 plaintiffs, explaining that "[t]his precise issue has been addressed by the Seventh and Ninth Circuits, which both held that plaintiffs could avoid federal removal jurisdiction under CAFA by carving their filings into separate pleadings").

46 *Anderson v. Bayer Corp.*, 610 F.3d 390, 393 (7th Cir. 2010).

47 *Id.* at 393-94 (citing *Tanoh*, 561 F.3d at 954).

48 131 S. Ct. 2541, 2551 (2011).

49 *Id.*; *see also In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 312 (3d Cir. 2008) (class certification "calls for the district court's ***rigorous*** assessment of the available evidence and the method or methods by which

(cont'd)

Most federal courts have taken heed of this key holding of *Dukes*, employing a "rigorous analysis" of the Rule 23 requirements for class certification.[50] But *Dukes* has not eliminated lax certification standards altogether, because some courts have resisted the Supreme Court's pronouncements. For example, recent rulings by the U.S. Courts of Appeals for the Sixth and Seventh Circuits constitute troubling precedents for class actions regarding allegedly defective consumer products. In two recent cases involving allegedly defective washing machines, these courts approved sprawling class actions, even though the vast majority of class members had not experienced any problems with their products.[51] According to the Seventh Circuit, the decision whether to certify is primarily one of "efficiency," and the presence of uninjured class members is no barrier to class treatment.[52] In so holding, the court appears to have forgotten a fundamental principle of U.S. law: the "benefits of efficiency can never be purchased at the cost of fairness."[53] By focusing exclusively on efficiency – without subjecting the putative class action to the type of "rigorous analysis" mandated by the Supreme Court – the Seventh Circuit departed from *Dukes* and set a troubling precedent for unwieldy consumer class actions that do not satisfy Rule 23 prerequisites.

Some federal courts in California similarly continue to apply weak certification standards to consumer class actions.[54] For example, in *Johnson v. General Mills, Inc.*, a federal judge in California refused to decertify a class action involving alleged misrepresentations regarding yogurt products.[55] The plaintiff asserted consumer-fraud claims under California law, alleging that the defendant misrepresented the ameliorative effects of the yogurt products on the human digestive system.[56] The court granted plaintiffs' motion for class certification before the Supreme Court decided *Dukes*. In the wake of *Dukes*, the defendants moved to decertify the class, arguing that a class action in the *Johnson* case "denies them of their due process right to

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plaintiffs propose to use the evidence to prove impact at trial") (emphasis added).

[50] *See, e.g.*, *In re Bisphenol-A (BPA) Polycarbonate Plastic Prods. Liab. Litig.*, 276 F.R.D. 336, 340 (W.D. Mo. 2011) (conducting a "rigorous analysis," which required that it "look[] behind the pleadings and ascertain[] the nature of Plaintiffs' claims as well as the nature of the evidence"); *Scott v. First Am. Title Ins. Co.*, 276 F.R.D. 474, 476 (E.D. Ky. 2011) (describing *Dukes* as a "landmark decision" that has strengthened the requirements for class certification).

[51] *See In re Whirlpool Corp. Front-Loading Washer Prods. Liab. Litig.*, 678 F.3d 409 (6th Cir. 2012); *Butler v. Sears, Roebuck & Co.*, 702 F.3d 359 (7th Cir. 2012). Petitions for certiorari have been filed in both of these cases.

[52] *Butler*, 702 F.3d at 362.

[53] *Malcolm v. Nat'l Gypsum Co.*, 995 F.2d 346, 350 (2d Cir. 1993); *see also Amchem Prods. v. Windsor*, 521 U.S. 591, 615 (1997) (class certification is only appropriate where it will "'achieve economies . . . without sacrificing procedural fairness'") (quoting Fed. R. Civ. P. 23 Advisory Committee Notes).

[54] *See, e.g.*, *Keegan v. Am. Honda Motor Co.*, 284 F.R.D. 504 (C.D. Cal. 2012) (certifying consumer-fraud claims under California law in defective car case where majority of class members experienced no issues with their vehicles' rear suspension); *Johnson v. Gen. Mills, Inc.*, 276 F.R.D. 519, 521-22 (C.D. Cal. 2011) (refusing to decertify class of yogurt purchasers where a large portion of the class likely continued to consume the product and were therefore not misled by the defendant's alleged misconduct).

[55] *Johnson*, 276 F.R.D. 519.

[56] *Id.* at 520.

defend the individual aspects of the class claims on a case-by-case basis."[57] The defendants specifically claimed that the reliance and causation requirements of California's consumer-protection statutes could not be "resolved 'in one stroke,'" as required under *Dukes* for class certification to be proper.[58] After all, many class members continue to buy the same yogurt to this day, despite the allegations in their suit that they were misled. The court rejected the defendants' arguments, however, opining that "*Wal-Mart* does not mandate that every element of a cause of action must be common."[59] The California federal judge then proceeded to deny the defendants' motion, concluding that "[t]he requirement of predominance in Rule 23(b)(3) itself implies that a court may certify a class even though there will, at some point, be issues that must be determined individually."[60]

Rulings like the ones summarized above will no doubt be relied upon by other district courts that seek to limit *Dukes* and resist heightened standards for class certification. The result could be a small but troubling group of magnet ***federal*** jurisdictions that employ lax class certification standards reminiscent of those followed by state courts before CAFA. Beyond damaging the vitality of American businesses, such a trend would also hurt American consumers as companies raise the prices of their products to alleviate the costs of imprudent class certification rulings and settlements.

C. Some Consumer Class Action Settlements Still Do Not Provide Benefits To Class Members.

Another problem that continues to plague federal class action litigation is increasing reliance on *cy pres* settlements. *Cy pres* refers to the practice of distributing unclaimed settlement money in class actions to third-party charities. *Cy pres* may seem like a solution to the problem of lawyer-driven class action settlements, but it is really just covering the problem up. In essence, *cy pres* is a way for class lawyers to justify their big fees without having to craft settlements that deliver any direct benefit to those individuals actually injured by the defendant's alleged misconduct. And because "[t]here is no indirect benefit to the class from the defendant's giving the money to someone else,"[61] it is questionable whether most *cy pres* distributions "effectuate . . . the interests of the silent class members."[62]

Recognizing these concerns, some jurists, including Judge Edith Jones of the Fifth Circuit, have emphatically rejected *cy pres* in favor of returning any unclaimed funds to the defendant.[63]

57 *Id.* at 521.

58 *Id.* at 521-22.

59 *Id.* at 522.

60 *Id.*

61 *Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004).

62 *Six Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1308-09 (9th Cir. 1990) (rejecting the use of *cy pres* in the case because the beneficiaries were too remote from the class).

63 *See Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 481-82 (5th Cir. 2011) (Jones, J., concurring) ("district courts should avoid the legal complications that assuredly arise when judges award surplus settlement funds to charities and civic organizations").

Judge Lee Rosenthal has similarly cautioned against unfettered use of *cy pres*, recognizing the potential of such awards to undermine the very purpose of the class device. As Judge Rosenthal has recognized, "[a] consumer class action is superior to individual suits because it allows people with claims worth too little to justify individual suits – so called negative-value claims – to obtain the redress the law provides. But if the consumer class action is likely to provide those with individual claims no redress . . . the consumer class action is likely not superior to individual suits."[64] Legal scholars have similarly criticized the practice, lamenting that *cy pres* renders "[t]he real parties in interest in . . . class actions . . . the plaintiffs' lawyers, who are the ones primarily responsible for bringing th[e] proceeding."[65]

A recent decision by the Third Circuit demonstrates that the use of *cy pres* promotes class actions as primarily lawyer-driven lawsuits. In *In re Baby Products Antitrust Litigation*, the Third Circuit vacated the district court's orders approving a class action settlement consisting of a substantial *cy pres* award in an antitrust class action brought against toy retailers and baby product manufacturers.[66] There, the defendant agreed to pay $35.5 million into a settlement fund with no reversionary rights; any unclaimed funds would be paid to specified charities. The trial court approved the settlement, which included payment of $14 million in attorneys' fees and expenses. In the wake of the district court's approval of the class settlement, it became clear that a measly $3 million of the settlement fund was actually claimed by class members, leaving $18.5 million to be paid to charities.[67] In other words, the attorneys received nearly five times the amount that actually ended up in the pockets of their clients. The Third Circuit reversed the class settlement, making several observations, including that *cy pres* awards reinforce the lawyer-driven nature of class actions. In particular, the Third Circuit explained that "inclusion of a *cy pres* distribution may increase a settlement fund, and with it attorneys' fees, without increasing the direct benefit to the class."[68] This recent ruling is a refreshing confirmation that some courts are finally starting to recognize that the propriety of class settlements should be tied to what class members actually receive.

Other courts, however, have not been as vigilant as the Third Circuit. In *Lane v. Facebook, Inc.*, which arose out of alleged privacy violations by Facebook, the Ninth Circuit affirmed a *cy pres* award aimed at establishing a new charity organization called the Digital Trust Foundation ("DTF") whose purpose it is to "fund and sponsor programs designed to educate users, regulators, and enterprises regarding critical issues relating to protection of identity and personal information online through user control, and the protection of users from online threats."[69] The Ninth Circuit denied a petition for rehearing *en banc*, but several judges dissented, explaining that the *cy pres* award was not "reasonably certain to benefit the class" and

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64 *Hoffer v. Landmark Chevrolet Ltd.*, 245 F.R.D. 588, 603 (S.D. Tex. 2007).

65 Testimony of Martin H. Redish, at 7, Hearing: *Class Actions Seven Years After the Class Action Fairness Act*, June 1, 2012, http://judiciary.house.gov/hearings/Hearings%202012/Redish%2006012012.pdf.

66 *In re Baby Prods. Antitrust Litig.*, Nos. 12-1165, et al., 2013 U.S. App. LEXIS 3379 (3d Cir. Feb. 19, 2013).

67 *Id.* at *6-7.

68 *Id.* at *16-17.

69 *Lane v. Facebook, Inc.*, 696 F.3d 811, 817 (9th Cir. 2012).

did not "advance the objectives of the [privacy] statutes relied upon in bringing suit."[70] Because the newly created charity has "***no*** record of service," the judges noted, its asserted commitment to "funding 'programs' regarding 'critical issues' says ***absolutely nothing*** about whether class members will truly benefit from this settlement."[71] In addition, the dissenting judges were unconvinced that the *cy pres* award would actually advance the objectives of the privacy statutes underlying the lawsuit, most of which prohibited the "***unauthorized*** access of disclosure of private information."[72] According to these judges, because the class claims concerned "***misconduct*** by Internet companies" – and not "users' lack of 'education'" – the DTF had virtually nothing to do with the basis of the lawsuit, which was further grounds for invalidating the settlement.[73]

II. STATE ENFORCEMENT OF FEDERAL LAW RAISES SERIOUS CONFLICT-OF-INTEREST AND PUBLIC CORRUPTION CONCERNS.

Another significant impetus for abusive aggregate litigation is the proliferation of arrangements under which state attorneys general hire outside counsel on a contingency basis to represent the state in civil litigation. This problem threatens to grow worse as more and more federal statutes give state attorneys general authority to enforce federal laws, including the Truth in Lending Act,[74] the Health Insurance Portability and Accountability Act,[75] the Consumer Financial Protection Bureau in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[76] the Restore Shoppers Online Confidence Act of 2010,[77] and the Consumer Product Safety Improvement Act of 2008.[78] Some commentators contend that partnerships between attorneys general and private counsel are a good idea because such suits are prosecuted without using tax dollars and are therefore in the public interest. However, these arrangements raise serious conflict-of-interest and other ethical questions.

Contingency-fee contracts between AGs and private counsel became popular during the landmark tobacco litigation of the 1990s. In that litigation, 36 states retained private contingency-fee attorneys to help them prosecute their lawsuits against the tobacco industry.[79] The litigation was highly successful from the perspective of plaintiffs' counsel, resulting in

70 *Lane v. Facebook, Inc.*, Nos. 10-16380, 10-16398, 2013 U.S. App. LEXIS 3935, at *2-3 (9th Cir. Feb. 26, 2013).

71 *Id.* at *4-6.

72 *Id.* at *6-7.

73 *Id.*

74 15 U.S.C. § 1640(e).

75 42 U.S.C. § 1320d-5(d).

76 12 U.S.C. § 5552.

77 Restore Online Shoppers' Confidence Act, Pub. L. No. 111-345 (2010).

78 15 U.S.C. §§ 1194(a), 1264(d), 1477.

79 Lise T. Spacapan, Douglas F. McMeyer & Robert W. George, *A Threat to Impartiality: Contingency Fee Plaintiffs' Counsel and the Public Good*, In-House Defense Quarterly, at 13 (Winter 2011).

approximately $14 billion in attorneys' fees for trial lawyers throughout the nation.[80] Since then, contingency-fee arrangements have extended well beyond the tobacco arena and have been employed in other mass-tort contexts.[81] In Rhode Island, for example, the state employed outside counsel to sue lead paint manufacturers from 2003 to 2008.[82] Similarly, AGs have entered into contingency-fee contracts with outside counsel to prosecute a wide range of lawsuits related to prescription medications, alleging failure to warn, fraudulent advertising and off-label promotion.[83]

In an effort to fully grasp the current state of the AG contingency-fee practice, three practitioners served Freedom of Information Act ("FOIA") requests on the AGs of all 50 states and the District of Columbia.[84] Of the 50 responses to the FOIA requests, 36 responses indicated that the AG's office uses or had used contingency-fee counsel outside the tobacco context.[85] The recent economic downturn and the budget problems faced by state governments are almost certain to make these arrangements even more popular. As one commentator noted in The Wall Street Journal, "trial lawyers representing public clients on contingency fee are suing businesses for billions over matters as diverse as prescription drug pricing, natural gas royalties and the calculation of back tax bills."[86]

> Trial lawyers love these deals. Even aside from the chance to rack up stupendous fees, they confer a mantle of legitimacy and state endorsement on lawsuit crusades whose merits might otherwise appear chancy. Public officials find it easy to say yes because the deals are sold as no-win, no-fee. They're not on the hook for any downside, so wouldn't it practically be negligent to let a chance to sue pass by?[87]

But there is a considerable downside to these lawsuits as well: they create an opportunity for unseemly liaisons between public enforcement officials and private, profit-motivated lawyers. For this reason, the growing use of contingency-fee contracts by state AGs has generated substantial criticism over the last few years. As one former attorney general who has been an outspoken critic of these arrangements explained, "[t]hese contracts . . . create the potential for

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80 *See* Leah Godesky, *State Attorneys General and Contingency Fee Arrangements: An Affront to the Neutrality Doctrine?*, 42 Colum. J.L. & Soc. Probs. 587, 588-89 (2009).

81 *See* Martin H. Redish, *Constitutional and Political Implications: Private Contingent Fee Lawyers and Public Power*, 18 S. Ct. Econ. Rev. 77, 81-82 (2010).

82 *See* Godesky, *supra* note 80, at 588-89.

83 Spacapan, McMeyer & George, *supra* note 79, at 14.

84 *See id.* Forty-nine states and the District of Columbia responded to the FOIA requests. *Id.* Due to a paper work error, New York was the only state that did not reply to the FOIA request. *Id.*

85 *Id.* Of the 14 states that did not report using contingency-fee counsel, only three states had statutes that explicitly limit the ability to hire private attorneys on a contingency-fee basis. *Id.* The remaining 11 do not appear to have any statutory prohibition. *Id.*

86 Walter Olson, *Tort Travesty*, Wall St. J., May 18, 2007.

87 *Id.*

outrageous windfalls or even outright corruption for political supporters of the officials who negotiated the contracts."[88] Critics have also condemned the practice as promoting "regulation through litigation," by empowering states to attack a wide variety of behavior by corporations merely by wielding the power of private attorneys.[89] But perhaps the most troubling consequence of these contracts is the violation of important constitutional rights of defendants, who find themselves facing lawsuits that combine the political power of the state and the financial power of deep-pocketed plaintiffs' lawyers. This concern was recently noted by Judge Danny Reeves in a case challenging the State of Kentucky's retention of contingency-fee counsel to sue a drug manufacturer. According to Judge Reeves: "If there is evidence that private counsel 'have ever engaged in any conduct that invaded the sphere of control' reserved to the AG's office, then the door is opened to a conclusion that the contingency fee arrangement violated the defendant's rights."[90]

Notably, federal prosecutors can only enter into these arrangements under limited circumstances. When the executive branch of the federal government enforces federal laws, a number of safeguards come into play, including statutes prohibiting public corruption, rules limiting the political activities of individuals hired by the government to assist in enforcing the federal laws, and Executive Order 13,433, which prohibits the use of contingent-fee arrangements with outside counsel retained by the federal government "unless the Attorney General has determined that the . . . entry into the agreement is required by law."[91] State AGs and the private attorneys they hire are generally not subject to these safeguards. As a result, the delegation of enforcement authority to state AGs poses serious conflict-of-interest and public corruption concerns that are generally absent in the federal arena.

What can be done about this practice? Some public officials are raising questions about private AG partnerships. For example, the Attorney General of Colorado, John Suthers, has stated that his "office policy is not to hire outside lawyers on a contingency-fee basis when the state's police power is being asserted (such as when the state brings an action based on a claim of public nuisance or when bringing a consumer-protection action)."[92] Similarly, former Florida attorney general Bill McCollum has also been an outspoken critic of the practice, warning that "[a]t the very least, use of such counsel without proper safeguards can give the appearance of impropriety and undermine public confidence in our legal system."[93]

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88 Adam Liptak, *If You Win, You Lose*, N.Y. Times, July 9, 2007, Section A, page 10 (quoting William H. Pryor Jr.).

89 *See* Brief of Chamber of Commerce of the United States of America & the American Tort Reform Ass'n as Amici Curiae in Support of Motion for Judgment as a Matter of Law in Light of Plaintiff's Constitutional Violations, at 20-21; *Oklahoma v. Tyson Food, Inc.*, No. 05-cv-00329-GKF-SAJ (N.D. Okla. June 12, 2007).

90 *Merck Sharp & Dohme Corp. v. Conway*, No. 3: 11-51-DCR, 2012 U.S. Dist. LEXIS 40940, at *12 (E.D. Ky. Mar. 26, 2012).

91 Exec. Order No. 13,433, Protecting American Taxpayers From Payment of Contingency Fees, 72 Fed. Reg. 28,441 (May 16, 2007).

92 John Suthers, *Avoiding Contingency-Fee Land Mines: New Attorneys General Should Use Outside Counsel Only as a Last Resort*, Wash. Times, Dec. 2, 2010, http://www.washingtontimes.com/news/2010/dec/2/avoiding-contingency-fee-land-mines/.

93 Testimony of Bill McCollum at 2, House Judiciary Subcommittee, Hearing: *Contingent Fees and Conflicts*
(cont'd)

But these voices of concern are not enough to stop the tide, and while some state legislative efforts on this front have helped reform the practice, federal intervention is also needed. As such, Congress should consider enacting legislation mandating that contracts between state AGs and outside counsel hired to enforce federal law be reasonable and prohibiting state AGs from retaining contingency-fee counsel to enforce federal law. Such legislation would promote the integrity of enforcement proceedings and safeguard the constitutional rights of defendants.

III. THIRD-PARTY LITIGATION FUNDING IS ANOTHER THREAT TO OUR CIVIL JUSTICE SYSTEM THAT WARRANTS ROBUST FEDERAL REGULATION.

Third-party litigation financing ("TPLF") describes the practice whereby a profit-motivated third party provides money to a litigant. TPLF generally falls into two broad categories: (1) ***consumer lawsuit lending***, which typically involves individual personal-injury cases; and (2) ***investment financing***, which includes investments in large-scale tort and commercial cases and alternative dispute-resolution proceedings. My focus today is on the latter: the growing practice under which investment firms provide financing to plaintiffs or their attorneys in exchange for a share of any recovery.

TPLF investments of this sort have several negative impacts on civil justice. ***First***, TPLF increases the filing of questionable claims. TPLF companies are mere investors, and they base their funding decisions on the present value of their expected return. As such, even if a lawsuit has little or no merit, it may be a worthwhile investment if there is a potential (however small) to recover a very large sum of money. In addition, TPLF providers can mitigate their downside risk by spreading the risk of any particular case over their entire portfolio of cases and by spreading the risk among their investors. For these reasons, TPLF providers have higher risk appetites than most contingency-fee attorneys and will be more willing to back claims of questionable merit.[94]

The most notorious example of this problem was the investment by a fund associated with Burford Capital Limited in a lawsuit against Chevron filed in an Ecuadorian court, alleging environmental contamination in Lago Agrio, Ecuador. Burford invested $4 million with the plaintiffs' lawyers in the Lago Agrio suit in October/November 2010 in exchange for a percentage of any award to the plaintiffs. In February 2011, the Ecuadorian trial court awarded the plaintiffs an $18 billion judgment against Chevron.[95] In March 2011, Judge Lewis Kaplan of the Southern District of New York issued an injunction barring the plaintiffs from trying to

(cont'd from previous page)
of Interest in State AG Enforcement of Federal Law, Feb. 2, 2012. http://judiciary.house.gov/hearings/Hearings%202012/McCollum%2002022012.pdf.

[94] *See generally* Paul H. Rubin, *On the Efficiency of Increasing Litigation*, paper presented to the Public Policy Roundtable on Third Party Financing of Litigation, Northwestern University Searle Center on Law, Regulation, and Economic Growth (Sept. 24, 2009).

[95] The Ecuadorian trial court awarded $9 billion in damages to the plaintiffs, which would be doubled if Chevron did not publicly apologize to them. Chevron did not apologize, and the damages were doubled to $18 billion.

collect on their judgment because of what he called "ample" evidence of fraud on the part of the plaintiffs' lawyers.[96] Long before Burford had made its investment in the case, Chevron had conducted discovery into the conduct of the plaintiffs' lawyers under a federal statute that authorizes district courts to compel U.S.-based discovery in connection with foreign proceedings, and at least four U.S. courts throughout the country had found that the Ecuadorian proceedings were tainted by fraud.[97]

According to a December 2011 press release, Burford "conclude[d] that no further financing w[ould] be provided" in the Lago Agrio case as a result of "[f]urther developments."[98] Nevertheless, its year-long involvement – and its initial decision to invest $4 million despite allegations of fraud in the proceedings – powerfully demonstrate that TPLF investors have high risk appetites and are willing to back claims of questionable merit.

Second, TPLF changes the traditional way litigation-related decisions are made. Traditionally, the plaintiff in a case and his or her counsel make strategy decisions together. TPLF interferes with that dynamic, because an investor will likely seek to exert control over strategic decisions in order to protect its investment. And realistically, if a plaintiff's lawyer is being paid by the investor, it will be difficult to resist that pressure. Even when the TPLF provider's efforts to control a plaintiff's case are not overt, the existence of TPLF funding naturally subordinates the plaintiff's own interests in the resolution of the litigation to the interests of the TPLF investor.

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96 *See Chevron Corp. v. Donziger*, No. 11-cv-0691 (S.D.N.Y. Mar. 7, 2011), at 82-83. The Second Circuit later vacated Judge Kaplan's injunction on jurisdictional and procedural grounds, but his factual findings stand. *See Chevron v. Naranjo*, No. 11-1150 (2d Cir. Jan. 26, 2012).

97 *See, e.g., In re Chevron Corp.*, No. 10-MC-21 (J/LFG) (D.N.M. Sept. 13, 2010) (finding "that . . . discussions trigger the crime-fraud exception because they relate to corruption of the judicial process, the preparation of fraudulent reports, the fabrication of evidence, and the preparation of the purported expert reports by the attorneys and their consultants."); *In re Application of Chevron Corp.*, No. 10-cv-1146-IEG (Wmc) (S.D. Cal. Sept. 10, 2010) (crime-fraud exception applies because "[t]here is ample evidence in the record that the Ecuadorian Plaintiffs secretly provided information to Mr. Cabrera, who was supposedly a neutral court-appointed expert, and colluded with Mr. Cabrera to make it look like the opinions were his own."); *Chevron Corp. v. Champ*, No. 1:10-mc-0027 (GCM-DLH) (W.D.N.C. Aug. 30, 2010) ("While this court is unfamiliar with the practices of the Ecuadorian judicial system the court must believe that the concept of fraud is universal, and that what has blatantly occurred in this matter would in fact be considered fraud by any court. If such conduct does not amount to fraud in a particular country, then that country has larger problems than an oil spill."); Hr'g Tr. at 44, *In re Application of Chevron Corp.*, No., 10-2675 (SRC) (D.N.J. June 11, 2010) ("In short, the provision of materials and information by consultants on the litigation team of the Lago Agrio plaintiffs in what appears to be a secret and an undisclosed aid of a supposedly neutral court-appointed expert in this Court's view constitutes a prima facie demonstration of a fraud on the tribunal."). On the Lago Agrio suit, *see generally* Roger Parloff, *Have You Got a Piece of this Lawsuit? The Bitter Environmental Suit Against Chevron in Ecuador Opens a Window on a Troubling New Business: Speculating in Court Cases*, Fortune, Vol. 163, Issue 8, June 13, 2011, at 68.

98 *See* Press Release, Burford Capital Limited, Burford Reports Continued Activity and Entry into UK Market (Dec. 12, 2011), http://www.burfordfinance.com/pressroom/press-releases. In January 2013, Burford released a letter it had sent to the Lago Agrio claimants' counsel in September 2011 accusing counsel of defrauding Burford into investing in the litigation. *See* Burford Group to Purrington Moody Weil LLP, Sept. 29, 2011, http://lettersblogatory.com/wp-content/uploads/2013/01/Burford.pdf.

Recent commercial arbitration between a company called S&T Oil Equipment & Machinery Ltd. and the Romanian government is illustrative. S&T had sought financing for its case from Juridica Investments Limited, and, under their agreement, Juridica paid some legal fees for S&T in exchange for a percentage of arbitration proceeds. After Juridica withdrew funding, causing S&T's case to collapse, a sealed complaint filed by S&T against Juridica in Texas federal court alleged that S&T's own lawyers had begun seeking legal advice from Juridica after Juridica began paying their fees, and that Juridica required the lawyers to share their legal strategy for the arbitration, along with factual and legal developments in the case.[99]

Third, TPLF prolongs litigation by deterring settlement. A plaintiff who must pay a TPLF investor out of the proceeds of any recovery can be expected to reject what may otherwise be a fair settlement offer, hoping for a larger sum of money in order to help pay off the investor.[100] The Chevron/Lago Agrio case powerfully demonstrates this problem. The investment agreement in that case included a "waterfall" repayment provision, which provided Burford with a heightened percentage of recovery on the first dollars of any award. Under the agreement, Burford would receive approximately 5.5% of any award, or about $55 million, on any amount starting at $1 billion.[101] But, if the plaintiffs settled for less than $1 billion, the investor's percentage would go up – in fact, the investor would receive the same $55 million for any recovery over $70 million. This sort of arrangement incentivizes plaintiffs to continue litigating in hopes of a higher settlement.

Fourth, TPLF investments compromise the attorney-client relationship and diminish the professional independence of attorneys by inserting a new party into the litigation equation whose sole interest is making a profit on its investment. In the litigation regarding injuries to 9/11 Ground Zero workers, for example, one of the plaintiffs' firms representing the workers was financed by a TPLF investment that provided for passing the interest charges on the investment on to the plaintiffs, to be paid out of any recovery by them. After settling with the defendants, the firm sought to pass along $6.1 million in interest payments to the plaintiffs. The judge overseeing the settlement acknowledged that passing on the interest to the plaintiffs may be permissible, but disapproved doing so in this case because it was not clear that the plaintiffs had understood or approved the charges.[102]

So what should be done about this problem? ILR believes that there needs to be a robust federal regulatory regime overseeing these investors and their activities. Specifically, ILR proposes the following measures: (1) designation of a federal agency to oversee TPLF investors

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[99] *See* B.M. Cremades, Jr., *Third Party Litigation Funding: Investing in Arbitration*, Transnational Dispute Management, Vol. 8, Issue 4 (Oct. 2011), at 25-33, 27 n.105 (citing *S&T Oil Equip. & Mach. Ltd. v. Juridica Invs. Ltd.*, No. H-11-0542 (S.D. Tex. Feb. 14, 2011), sealed complaint, ¶¶ 29, 30.

[100] *See Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217, 220-21 (Ohio 2003) (noting that the amount the plaintiff-appellant owed to litigation financiers was an "absolute disincentive" to settle at a lesser amount).

[101] *See* Funding Agreement Between Treca Financial Solutions and Claimants, *Chevron Corp. v. Donziger*, No. 11-cv-0691 (S.D.N.Y.), Docket No. 356, Ex. B.

[102] *See* Tr. Of Proceedings, *In Re World Trade Center Disaster Site Litig.*, No. 1:21-mc-00100 (S.D.N.Y. Aug. 27, 2010).

and make regulations concerning TPLF investments; (2) enactment of statutory safeguards to avoid TPLF-related abuses; (3) barring the use of TPLF in class actions; and (4) amending the Federal Rules of Civil Procedure to address TPLF arrangements.

A. Appointment Of A Federal Agency To Oversee TPLF Investments

First, ILR believes Congress should enact legislation appointing a federal agency to oversee TPLF investments, with three specific grants of authority: (i) to license TPLF investors; (ii) to make rules and regulations governing TPLF investments; and (iii) to enforce any laws, rules and regulations governing TPLF investments.

Licensing will permit effective oversight of TPLF investors and guard against potential abuses by them. Any effective licensing regime would require a TPLF investor, as a condition of obtaining a license to operate, to disclose the identity and interest of all members of the TPLF investor's board of directors and all senior executive officers. In addition, ILR proposes that any applicant for a license to invest in lawsuits be required to pay a $1 million fee. This money would remain in an account administered by the federal agency, with any interest or dividends going to fund enforcement and oversight activities by the agency.

The TPLF regulating agency should also be authorized to promulgate such rules and regulations as are necessary to carry out its mandate. This authority would enable the agency to create a comprehensive regulatory regime appropriate to carry out the intent of Congress in passing the legislation to govern TPLF, much as the Securities and Exchange Commission ("SEC") has done with respect to the statutes, like the Securities Act of 1933 and the Securities Exchange Act of 1934, that are within its purview.

Finally, the agency should have meaningful authority to enforce all laws, rules and regulations governing TPLF investments. As part of this authority, the agency should be empowered to bring lawsuits in federal court and obtain civil penalties for violations. Again, Congress's grant of authority to the SEC to bring civil actions to enforce the securities laws and its rules and regulations is instructive. The agency should (like the SEC) have the power to seek scaled monetary penalties against violators, based upon the seriousness of the offense and to seek enhanced penalties for repeat violations.

B. Statutory Safeguards Against Abuses In TPLF Investments

In addition to legislation designating a federal agency to oversee TPLF investments, Congress should implement specific safeguards that the agency may enforce. These safeguards should include the following:

- Barring law firm ownership of TPLF investors;
- Requiring any person who is responsible for repaying a TPLF investment to be a party to the investment agreement and explicitly consent to all of its terms;
- Prohibiting TPLF investors from controlling the litigation they are financing;

- Requiring each TPLF investor to post a bond with respect to each lawsuit it funds;
- Holding TPLF investors jointly and severally liable with the plaintiff for satisfying any cost awards; and
- Requiring TPLF investors to pay the attorneys' fees and costs of the prevailing party if the party they fund does not prevail at trial.

C. Barring The Use Of TPLF In Class Actions

Congress should also enact legislation barring TPLF in class actions. Proponents of TPLF insist that it is necessary to increase access to justice for plaintiffs. In the United States, however, we already have two methods to increase court access: contingency fees and the "American rule" against fee shifting. A plaintiff wishing to commence a suit in the United States can therefore do so without risk: there is no cost to the plaintiff to retain an attorney to file and prosecute the suit, and generally no consequences if the plaintiff loses. This is true from the simplest individual slip-and-fall case to the most complex class action. Because plaintiffs' attorneys are willing and available to take class representations on a contingency-fee basis that can produce far greater compensation than individual cases (and indeed, they often compete for the opportunity to do so), TPLF is simply not necessary in the class action context.

Moreover, class actions, by their nature, already raise significant concerns regarding lawsuit abuse because the individual class members generally do not control the litigation, which is spearheaded by class counsel. In a large consumer class action, the average plaintiff often has only a dollar or two at stake. The "representative" plaintiffs who are empowered to speak for the class in such cases tend to be friends, neighbors or even employees of the attorney bringing the suit. As a result, the lawyers fully control the cases – not the individual plaintiffs.

This concern would be exacerbated if the person driving the litigation is not even a lawyer with fiduciary obligations to the supposed clients or the court. In a case with a legitimately aggrieved plaintiff who is following the litigation and concerned about its outcome, there is, at least, someone watching the lawyer and the funding company – and that person can raise concerns if the funding company acts against his or her interests. In a class action, by contrast, there is rarely a truly interested plaintiff. Thus, the TPLF company can effectively run the litigation with no check on its actions. For these reasons, TPLF should not be permitted in class actions.

D. Promulgation Of Court Rules Addressing TPLF

The last aspect of a comprehensive federal TPLF oversight regime would be new rules of civil procedure. The focus of such rules, like the proposed licensing scheme discussed above, would be disclosure of TPLF arrangements at the outset of civil litigation. Meaningful disclosure requirements would shine much-needed light on TPLF investments. As previously discussed, one of the biggest consequences of TPLF is the erosion of a plaintiff's control over his or her own lawsuit. Lawsuit investors seek to control their investments by managing strategic decisions in litigation they finance. As a result, TPLF undermines the bedrock principle that a party to a lawsuit has the ultimate decision-making authority with respect to that suit. The pernicious effect on defendants is clear: because TPLF agreements are typically made under a "veil of secrecy,"[103] a defendant facing a claim funded by TPLF may not even realize who is guiding litigation strategy and decisions on the other side, making it unfairly difficult to mount an adequate defense.

Strong disclosure requirements will correct this problem. In particular, ILR proposes amending Federal Rules of Civil Procedure 26 (requiring initial disclosures) and 7.1 (requiring corporate disclosure statements) to provide for specific disclosures of TPLF investments in funded cases. Requiring disclosure of information pertaining to TPLF investments is sensible. If a company has an interest in litigation that is contingent on the outcome, it is in many respects a real party to the litigation. Parties have the right to know who is on the other side of litigation.

CONCLUSION

The past decade has witnessed a number of meaningful reforms to our civil justice system – most notably, the enactment of CAFA. This has resulted in a fairer class action landscape. However, despite these significant advances, litigation abuses continue to mar our nation's civil justice system, hurting both businesses and consumers. For one thing, while CAFA has leveled the class action playing field by shifting countless interstate class actions into federal court, some courts have deviated from Congress's intent to expand federal jurisdiction over such proceedings. Specifically, by imposing heightened standards for removal and broadly construing certain narrow exceptions to federal jurisdiction under CAFA, these courts have forced class action defendants to continue defending interstate class actions in magnet state court jurisdictions that employ lax class certification standards. In addition, some federal courts have undermined the import of CAFA by failing to apply the Supreme Court's "rigorous analysis" standard for class actions filed in – or removed to – federal court. Beyond these serious concerns, another abusive form of aggregate litigation, the enforcement of federal law by state AGs and private contingency-fee counsel, remains largely unchecked and poses troubling conflict-of-interest and ethical issues in state enforcement proceedings. And finally, the advent of third-party litigation funding represents another serious challenge to our civil justice system. This growing practice, which threatens to transform American courts into unseemly investment vehicles, will foster frivolous litigation, jeopardize client control over litigation and compromise the attorney-client relationship, among other consequences.

These litigation abuses represent significant challenges to our civil justice system, but there are a number of potential legislative responses that would mitigate them. For example, Congress should enact legislation prohibiting state attorneys general from using contingency-fee arrangements to enforce federal law. In addition, Congress should institute a comprehensive regulatory regime for TPLF that is supported by stringent disclosure requirements to minimize the deleterious effects of this practice on our nation's civil justice system.

Thank you for inviting me to testify today, and I am happy to answer any questions you may have.

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[103] Parloff, *supra* note 97, at 68, 72.

Mr. FRANKS. Thank you. And I thank you all for your testimony.

We will now proceed under the 5-minute rule with questions. And I will begin by recognizing myself for 5 minutes.

And I will start with you, Ms. Milito.

Ms. Milito, you stated in your written testimony that we "must also address the reality that small business defendants are rationally discouraged from vindicating their rights in court under the current legal rules."

Now, it seems to me that you are essentially saying that an innocent small business may have to pay money to trial lawyers to avoid paying an even more significant amount by litigating their cases to victory.

Is that true? Or can you elaborate?

Ms. MILITO. Yes, certainly. And that is true. And I think, actually, the point was made in part by Mr. Conyers' statement, too, who I think referred to large, costly cases. Hearing about these large, costly cases that you read about in the news, these class-action, that feeds into the fear that I hear from small business members who oftentimes, when they are threatened with a lawsuit or they receive that demand letter in the mail, their first thought is, my goodness, what do I do and how much is this going to cost me, because there is an immediate recognition that, like with Mr. Volpi, I am going to need to get an attorney and attorneys are expensive.

And in this respect, I am a kind of aligned with my members. I have been out of private practice for nearly 20 years, so I get sticker shock, too, when I hear about what attorneys cost, as do our members. And our members have an appreciation that attorneys, whether they are plaintiff's attorneys or defense attorneys, are entitled to get paid. They have an expertise, like Mr. Beisner. But it is expensive, and it is costly to defend these cases.

So I spoke with a member, ironically, just yesterday, who has been threatened with a wage and hour issue. And she has already paid her attorney nearly 5 hours, and she said, you know, this is $260 an hour. As of right now, we don't even have the complaint. I just do not know what to do. I am at the point where I kind of want to pay off this individual, even though I do not think I did anything wrong. I do not think I violated any wage and hour law, but I just want this to end, because I do not know how long this is going to go on. They just want to get out.

So it is very often—they are not going to go and engage in long, costly discovery, my members. They may not even ever see a complaint, like this member I spoke to yesterday. They want to kind of, as much as they hate to throw up their hands in defeat, they want to pay, get out and just kind of make this go away so they can get back to running their business.

Mr. FRANKS. Mr. Frank, you stated in your written testimony, "At a minimum, the parties should be required to give notice to the class of who the cy pres recipients are and whether there are relationships between the recipients and the parties, attorneys, and judge." Though this information seems obviously material to the fairness of the settlement, courts have generally refused to establish bright line rules that penalize parties that hide this information from class members.

Could you please elaborate on why some courts are reluctant to make the cy pres system more transparent and what Congress might do to rectify that?

Mr. FRANK. I do not understand why the courts are not creating the bright light rules here. To me, it seems an obvious solution, and one answer is that I am litigating against millionaire attorneys who have a lot of money at stake, and if I win on that point, they might not get their money, so they throw as much mud into the litigation process as possible to protect themselves on that issue.

Congress can certainly require notice to have these things. In the Class Action Fairness Act, for example, defendants are required to give notice to State attorneys general about a pending settlement, so that the State attorney general can come in and intervene on behalf of class members who are treated unfairly. Unfortunately, that provision has not had very much effect, because most State attorneys general have just sort of ignored it.

But similar provisions to the existing 1715 in requirements and notice, and holding that a defendant does not get the benefit of waiver, if the notice does not have these provisions, or that attorneys will be punished if they fail to make the appropriate disclosures, will create the right incentives so that class members know went attorneys are diverting money to their alma mater or to their ex-wife's charity.

Mr. FRANKS. Thank you, sir.

Mr. Beisner, has President Obama withdrawn the previous Administration's executive order that bans the Justice Department from hiring contingency fee lawyers, unless required by law? And if not, what would that say about the President's policy?

Mr. BEISNER. To my knowledge, that executive order is still on the books. And to be clear what it means is it precludes the Federal Government, when it is going to enforce laws, from getting contingency fee counsel involved in the litigation. And to me, it is a policy saying that is something the Federal Government should not do in enforcing its laws, and that should apply when State AGs are enforcing Federal law as well.

Mr. FRANKS. Thank you. And I would now recognize the Ranking Member for 5 minutes, Mr. Nadler.

Mr. NADLER. Well, thank you. I want to say, if anything useful has come out of this hearing so far it is that I have found out about that executive order from the President saying that the AGs shall not hire contingency fee lawyers, and I will do my best to get that revoked as soon as possible.

Ms. Doroshow, Mr. Beisner claims that contingency fee agreements between State AGs and private counsel are somehow problematic. Can you explain how these agreements really operate and the risk that taking a case on a contingency fee entails?

Before you do that, let me read something that will set the stage for this question. Very often, the State AG will find himself outclassed by very large law firms hired by very rich litigants. So for example, in the tobacco litigation, the strategy of the tobacco companies with bury everybody in paper and make it too expensive to fight. A memo written by counsel for R.J. Reynolds Tobacco made it clear that outspending litigants and forcing them to abandon their claims was the core staple of the tobacco industry's litigation strategy. I quote from the memo, "The aggressive posture we have taken regarding depositions and discovery in general continues to make these cases extremely burdensome and expensive for plaintiffs' lawyers. The way we won these cases was not by spending all of RJR's money but by making that other SOB spend all of his."

Could you comment on some of the proposals you have heard in the context of this kind of memo about prohibiting State AGs from hiring contingency fee lawyers?

Ms. DOROSHOW. Sure. The State AGs make rare use of contingency fee lawyers, but they do so if they are in a situation where the office is underresourced and understaffed, and they need to enforce State law and protect their consumers, and they do not have the staff to do that. So they bring on contingency fee lawyers who, by the way, like all contingency fee lawyers, are paid nothing until and unless the case is won.

And in this case, the payments, the fees, are paid from the company that has been determined to have broken the law. Taxpayers do not pay these fees. Not only that, taxpayers in many cases—the tobacco cases being a good example of that, but there are many, many others—have recovered millions and millions of dollars as a result of these State AG cases.

Mr. NADLER. So, Mr. Beisner, why is that not a great public service?

Mr. BEISNER. Well, I am not sure I agree with the factual premise on that.

Mr. NADLER. Well, let us put it this way: By definition, if you win the case, it is not a frivolous case. You won. The courts have determined it is not.

Mr. BEISNER. Oh, yes.

Mr. NADLER. If an AG, through a contingency fee lawyer, wins millions of dollars in damages for the taxpayers or for some injured class in the State, what is wrong with that?

Mr. BEISNER. Because there is a huge cost to the State to do that, because the lawyers involved keep 40 percent of the money that came in.

Mr. NADLER. But if that had not happened, the State would have gotten zero and the State could not have afforded to bring the case in the first place.

Mr. BEISNER. If the State had decided that it was a priority, it could have paid those attorneys by the hour, as many States do. Many States do not have——

Mr. NADLER. But that might cost a fortune. And then you run into the problem that you are up against the tobacco companies, some other big company that is just trying to run up your costs. Isn't this a good way around that?

Mr. BEISNER. No, it is not. And I think it also ignores the fact that through NAAG, and other resources, the attorneys——

Mr. NADLER. Through what?

Mr. BEISNER. The National Association of Attorneys General. Sorry. They are able to pool resources and be very effective.

Mr. NADLER. Ms. Doroshow, would you comment on that? And on the 40 percent figure?

Ms. DOROSHOW. Well, I mean, yes, they are not charging 40 percent. You know, I think in these cases, they usually are charging far, far less than the normal one-third fee.

But in any event, this is not money that the taxpayer is paying. This is money that the defendant is paying. The company that broke the law is paying these fees, not the taxpayer.

Mr. NADLER. Let me ask you one other question, Ms. Doroshow, and then Mr. Beisner.

The Attorney General is an elected official in most States. Shouldn't he make that judgment? Why should the Federal Government, as I gather Mr. Beisner would have us do, prohibit the exercise of judgment by an elected official as how to allocate resources and protect his constituents?

Ms. Doroshow, first.

Ms. DOROSHOW. You know, this is something that is obviously a State issue. Congress should have no involvement in it. There are some State laws, 20-some, that provide Federal and State concurrent authority to enforce the law. In our organization, and there was testimony actually last year by Amy Widman, a law professor at Northern Illinois University, about the research that they did to show that that concurrent enforcement authority with AGs——

Mr. NADLER. But I mean, Mr. Beisner would say that the Federal Government should prohibit the attorney general, who is an elected State official, from using his or her judgment as to whether to hire a contingency fee lawyer to vindicate or try to vindicate the rights of the consumers or the taxpayers or whoever in the case. We should interpose our judgment and say you may not do that.

He is an elected official. He is not risking State money. Why shouldn't he be allowed to do that?

Ms. DOROSHOW. The Federal Government should stay out of this.

Mr. NADLER. And if I could ask——

Mr. FRANKS. The gentleman's time has expired.

Mr. NADLER. Could we let Mr. Beisner answer the question?

Mr. FRANKS. Please finish the question.

Mr. BEISNER. Let's be clear that what we are talking about is when that judgment is being made about enforcing Federal law. What we are talking about is not State AG enforcement of State laws.

Mr. NADLER. I thought we were talking about State AGs?

Mr. BEISNER. We are talking about State AGs enforcing Federal law under those statutes that permit it. And there we are saying there is a distinct Federal interest in saying, since the Federal Government, by executive order, does not use contingency fee counsel, that policy judgment has been made. And where that authority for enforcement has been delegated to the State, that shouldn't be used there either.

Mr. FRANKS. The gentleman's time has expired.

I would now recognize Mr. DeSantis for 5 minutes.

Mr. DESANTIS. Thank you, Mr. Chairman. Thank you for conducting this hearing. Thank you to the witnesses.

You know, I think that litigation abuse in an important issue. It is interesting the Founding Fathers, if you look back, they thought attorneys would be very trustworthy and the type of people who would really be able to be leaders. And obviously, I think we have seen a change in how the profession is viewed by the public, and I think this is one of the reasons why.

Ms. Milito, you talked about in your testimony that many of your members receive cases brought against them, sometimes threatened, but sometimes actual cases. They look at it and they are pretty convinced that they would be able to win on the merits, if they did not do anything wrong, but then they face the calculation of, okay, how much is it going to cost me to defend the case?

And so, even if they win, oftentimes they are better off just cutting a check to somebody to be able to go away, not just purely based on economics, although that is obviously a calculation, but the time and effort that they would have to invest in the case.

Is that a pretty standard thing that you hear from your members? Having to make that type of choice?

Ms. MILITO. Definitely, yes. It is a simple cost-benefit analysis. And you are right to hit on, too, the anxiety, the stress, the time away from the business, kind of the incalculable financial costs that go into the decision to settle a case where they do feel that, hey, I did nothing wrong here.

And you know, even the situation going back to Mr. Volpi, the frustration he expressed to me was my attorney told me that I could file a motion to recoup my attorneys' fees, but filing the motion and the fight to recover that would probably cost $4,000. And he said, so to pay $4,000 to get $1,000 back and the end of the day makes absolutely no sense.

So it is just a cost-benefit analysis, and that is why they try to get out.

Mr. DESANTIS. In your testimony, you mentioned how the incentives in our system are structured to kind of lead to this outcome over and over again. Would your members be receptive—many of these cases may be done under State law, so it wouldn't be for us to get involved, if that is the case.

But would they be open to reform where they would be able to recover attorneys' fees? Like in Britain, the loser will just pay the fees. It seems to me that would change the incentives for some of these cases being brought.

Ms. MILITO. Certainly, we have some members that I think I have heard from that would support that. But I think it is more disincentivizing attorneys and, certainly, a lot of attorneys—most attorneys, I think, comply with the highest ethical standards. I do want to say that at the outset, and I think our members would say that, too.

It is kind of these bottom feeders, if you will, that are going after the low dollar cases with small businesses. And so disincentivizing the frivolous claims by maybe strengthening Rule 11 sanctions, making it easier to recover sanctions. And this does get into, as you pointed out, some State law issues, too, with consumer statutes not allowing recovery of fees when you bring those claims. Those sorts of things.

I think there are other areas that you could look at, too.

Mr. DESANTIS. Okay, great.

Mr. Beisner, in terms of the contingency fees with these State AGs, just in your experience, is there ever a time when you just absolutely need to do a contingency fee? Or could these cases be dealt with without that?

Mr. BEISNER. I think, for the most part, they can be dealt with without attorneys' fees. You know, I think there are some instances where States have tax collection operations and so on, where that may be the only approach that is available to them.

I think what is of most concern, though, is the idea that when you hire contingency fee counsel and basically pin the attorney general's badge on them, there are really worries about handing over control of litigation to somebody who has a financial interest in the outcome.

It is like saying to traffic officers, go out and give tickets and you can keep half of the money you collect. You worry about the public perception that the judgment, the prosecutorial judgment that ought to be exercised when you are using the authority of the State, when you have that badge pinned on, it is not being properly used. And that is the concern in these larger cases, that are really prosecutions of a sort, about the use of contingency fee counsel.

Mr. DESANTIS. And do you know, from your experience, how are these contingency fee attorneys selected by the State AG? Is there a system, or is it just kind of ad hoc?

Mr. BEISNER. It varies from State to State. I should start by saying there are some States and some State attorneys general who say we are having nothing to do with this. We do not want this at all, and have made that judgment.

Other jurisdictions in recent years have enacted legislation, in large part because of the abuses that were recognized coming out of the tobacco litigation of how counsel were selected and how much they were paid, that requires all of this to be done in the sunshine.

And then there are other States where there is a little bit of an anything-goes situation. And I think there are concerns that in some of those jurisdictions, you do have a little bit of a pay-to-play sort of situation, where there does seem to be some correlation between campaign contributions and which counsel gets selected to carry on these activities on behalf of the State.

Mr. DESANTIS. That was going to be my next question.

So with that, thank you, Mr. Chairman. I yield back.

Mr. FRANKS. Thank you, Mr. DeSantis.

I will now recognize Mr. Conyers for 5 minutes.

Mr. CONYERS. Thank you, Mr. Chairman.

There seems to be two schools of thought here demonstrated by three of the witnesses.

Attorney Doroshow, is that the correct pronunciation?

Ms. DOROSHOW. Doroshow, actually. But that's fine.

Mr. CONYERS. Doroshow.

How do we deal with the question of, for example, supposedly frivolous cases that would otherwise be flooding courts?

The *Iqbal v. Ashcroft* decision by the Supreme Court said that the court should dismiss claims if they are not plausible. And what I am hearing here is a number of criticisms that these claims are not being dismissed, even though they are frivolous.

That seems like we might want to hold a hearing to determine the accuracy of that among the different courts, the Federal and State court itself.

Ms. DOROSHOW. Well, I do think Iqbal, those cases have made it very difficult for many cases to proceed. And I think it would be worthwhile to take a look at the impact that that has had on the dismissal of legitimate cases that should be in court.

I mean, the reality is that tort cases are dropping, and they have been dropping substantially in this country for years. They have been down 25 percent in the last 10 years, while business cases, including contract cases, have gone up 62 percent.

So I think the proof is this in the statistics. There are plenty of mechanisms. Rule 11 is certainly another one that provides judges enough tools to dismiss frivolous cases, and they are being dismissed.

But also legitimate cases are being dismissed, and that is, in my view, a more serious problem.

Mr. CONYERS. Well, let's look at class actions. For many with relatively small claims, there is no other way for a victim to get into court. And what I am hearing now is that the poor corporate defendants need some help.

And this hearing seems to be designed to create sympathy for the corporate lawyers, who are clearly more affluent than the consumer class of lawyers. And it seems to be just backward, as far as I am concerned.

The corporations, through tobacco suits and others, can keep you in court. As a matter of fact, now an appeal can take a victory away from a plaintiff, and we are here worrying about the corporations and how terrible it is that they are subject to class-action suits. And it seems to me that it is just the reverse.

Where do you come out in evaluating this part of it?

Ms. DOROSHOW. It is pretty clear that the Concepcion case has resulted in the dismissal of class actions, because of the class-action ban that now has been legitimized by the Supreme Court.

I mean, these cases are not being brought, basically at all, because if you do not have the class-action tool, then small claims cannot be brought it all. And I think that is a result of that, the primary result of that case.

Mr. CONYERS. The last question is on the contingency fee contracts. They have been, more or less, demonized in this discussion. Can we justify them under certain conditions?

Ms. DOROSHOW. Well, contingency fees are the only way that individuals can get access to the courts and, in many cases, State attorneys general, as well, who are underfunded and understaffed.

It is a critical part of the civil justice system. And conservative groups agree. The American Enterprise Institute even published a study called, "Two Cheers for the Contingent Fee."

Mr. CONYERS. Amazing. And I thank you very much.

I yield back, Mr. Chairman.

Mr. FRANKS. Thank the gentlemen.

And I now recognize the gentleman from Iowa, Mr. King.

Mr. KING. Thank you, Mr. Chairman.

And I thank the witnesses.

As I listen to the testimony and review it, just for me, I always like to get to: How do we fix this in a big way? And then, if we cannot get there, how do we back up to what we can get done?

I did not hear the proposals for those solutions, but I first wanted to ask, and I think I will go first to Ms. Milito, do you know of a country that has more rampant litigation than the United States? Anyplace on the planet?

Ms. MILITO. I mean, from the reports I have read, there is a litigation problem, and certainly our members perceive that our country is too litigious. I mean, I have not compared, myself, data, but, I mean, it is kind of sue first and think later, is what I heard from a member recently.

Mr. KING. Do you believe that it affects our culture and our quality of life?

Ms. MILITO. I think it affects the culture for a small-business owner. This kind of this climate of fear pervades. One issue that was brought up was about NFIB's problems and priorities poll and how a lawsuit is lower on our problems and priorities. But I point out that, in 2011, NFIB's research foundation polled small employers—not just NFIB members, but small employers nationwide—and 40 percent identified regulation and legal issues as an impediment to growth.

So it is this regulatory and legal combined together that is an impediment to growth. So it does impact business owners.

Mr. KING. I would just give you a cultural narrative, a short one, and that would be a small town that was on a lakeshore that had one lot that belonged to the city. And they always put a dock out there for public use. And it was nice that there was open access to the public along an otherwise private shoreline. And someone went out there and put one of those steel fishing rod holders on the dock post, and a little kid jumped in, cut his arm on that.

It turned into litigation. The result of the litigation was no dock, no public access. The beach is shut down.

That is an example of how our lives aren't as rich as they might be if it weren't for this litigation.

I would ask if there is anyone on the panel that knows of a country that has more rampant litigation than the United States. Signal to me, and I will recognize you.

Mr. Beisner.

Mr. BEISNER. Yes, I certainly do not. And I think that part of the reason for that is, if you look at our legal system versus virtually every other country's legal system, first of all, they do have a principle in most other countries with more sophisticated legal systems that if you file a lawsuit and you do not win, there are consequences. You pay all or part of what the other side had to invest in defending itself.

Also, most other countries do not have contingency fees.

Now, I am not necessarily saying we should move away from that, but in answer to your question——

Mr. KING. You are starting to convince me, however.

Mr. BEISNER. The reason we have a lot more litigation and part of the reason I worry about this third-party litigation funding I was referencing is because now you have what are basically hedge funds coming in and saying, "We have a new stock market. We have a new place to invest," which is going to cause the amount of litigation to increase even further.

Mr. KING. But your recommendation, when you get to that point of no contingency fees and loser pays, those two components of your discussion, what would be your recommendation on how we fix this?

Mr. BEISNER. I am not sure that we necessarily should back away from the contingency fee system. I think we need to have some restrictions on when it is used.

And I wouldn't necessarily advocate a full loser pays system, but to think about whether there should be allocation of costs of discovery, which is a huge expense in many of these cases, when one side wins or loses, may be an area to look at.

But there needs to be some consequences there to the decision to file litigation. And that is part of the problem now. You can just file a lawsuit. And if it does not work, no harm, no foul.

Mr. KING. Ms. Doroshow, can you give us an example of an incident where an American citizen could have something calamitous happen to them and there would be no one liable but themselves?

Ms. DOROSHOW. Yes, as a result of the *Riegel v. Medtronics Supreme Court* case, currently, victims of defective class III medical devices—that is like heart defibrillators and pacemakers—have no remedy. And there are thousands of these cases that have been dismissed, of people with these kinds of very serious and defective medical devices.

Mr. KING. And, Mr. Frank, what do you have to say about the question?

Mr. FRANK. That characterization, I think, mischaracterizes the real decision, and confuses product design with defective products.

A product that does not meet the FDA's standard still provides some remedy. It is only when the FDA has approved the product design that the Supreme Court has held that juries do not get to second-guess the FDA's decision.

Mr. KING. I thank all the witnesses. I see I have run out of time. I appreciate your testimony, and I yield back the balance.

Mr. FRANKS. I thank the gentleman. And I now yield to Mr. Deutch for 5 minutes.

Mr. DEUTCH. Thank you, Mr. Chairman.

Mr. Beisner, you raised a couple points that I found pretty interesting.

You started to explain that there are occasions where it is appropriate for States to engage outside counsel. You talked about tax collection cases. You said those are really the only ones, and those are really like prosecutions. Can you explain that?

Mr. BEISNER. I think what I am getting at is where you have— you may find some room for it where you have a liquidated amount that is owed to the State, so that when you give this to an outside counsel, there is not this notion of discretion that is being exercised in what is being——

Mr. DEUTCH. A liquidating amount owed to the State based on what?

Mr. BEISNER. If I am a taxpayer and I owe $1,000 to the State, for the State to get some assistance in collecting that liquidated amount does not involve a lot of prosecutorial discretion.

I think it is where you get into the "I want to prosecute for wrongdoing" sort of category where this gets to be more of an issue.

Mr. DEUTCH. So in that case, if the purpose is to go after someone who owes money to the State, then I would suggest that it is worth taking a look, as some my colleagues have, at the tobacco litigation.

The tobacco litigation, I do not need to remind you, was not litigation brought by States in order to punish tobacco companies. The tobacco litigation was brought by States because of the billions and billions of dollars in health care costs that the taxpayers in those States had to pay as a result of the products that tobacco companies were making.

So when those cases were brought, in 46 States that settled in '98, the tobacco industry paid more than $200 billion.

And without the outside counsel, to think that there could have been some reliance on the small attorneys general offices in every State to bring that litigation is outrageous.

In fact, and I think Mr. Nadler touched on this, you do not have to take our word for it. When R.J. Reynolds' lawyer explained, and I quote, "The aggressive posture that we have taken regarding depositions and discovery in general continues to make these cases extremely burdensome and expensive for plaintiffs' lawyers, particularly sole practitioners. To paraphrase General Patton," he said, "the way we won these cases was not by spending all of Reynolds' money but by making that other son of a bitch spend all his."

If I as a taxpayer in the State of Florida know that the only way that we are going to be able to be compensated for the harm done to the taxpayers—because, really, that is what this whole hearing is about, the cost to our society—then I want to be sure that we do everything we can to make sure that the State will be fully compensated.

And if I am up against someone who has made it his sole purpose to drag out—and with all due respect to Mr. Frank and his crusade against millionaire attorneys, when the tobacco companies' own lawyers say that the whole point of this is to drag it out, to make it impossible for the States and, ultimately, in the class-action suits, to make it impossible for those who have been injured by that product that kills people, then how is it possible that the only time we could possibly permit class actions is when taxes are involved?

Mr. BEISNER. Well, I will make two points on this.

First of all, in the tobacco litigation, it is not the sort of situation I was talking about, because it was not at all liquidated. There were huge debates about what the causation is there, with a huge amount of discretion——

Mr. DEUTCH. I am sorry, I am sorry. Mr. Beisner, hold on a second.

I do not want to relitigate the tobacco litigation. It is not my practice. I was a real estate lawyer.

There is a huge amount of debate about what the causation was for what?

Mr. BEISNER. What the relationship was——

Mr. DEUTCH. Between smoking and cancer?

Mr. BEISNER [continuing]. With smoking and what the health effects were.

Mr. DEUTCH. Between smoking and cancer. That is still debatable?

Mr. BEISNER. Well, between the costs that——

Mr. DEUTCH. No, are we still debating that point?

Mr. BEISNER. No, I am not debating. What I am saying is that between the actual costs that were incurred by the State on that issue.

And let me just note, in terms of—the States weren't made whole by that litigation, because many of the States then legislated to shut down that sort of contingency.

Mr. DEUTCH. Mr. Beisner, I only have another minute. I want to touch one other thing you said.

You said that you are worried about the sullying of the reputation of our legal system. You talked about, in response to a question from one of my colleagues, this idea of pay-to-play and the correlation between contributions made to attorneys and who is hired as lawyers by the State.

I am just curious, if you know the figure, the amount of money that the U.S. Chamber contributed in judicial races across the country? Do you know that figure?

Mr. BEISNER. I don't.

Mr. DEUTCH. And can you tell me why the Chamber would contribute to judicial races? Because again, my focus is, again, on ensuring that the reputation of the legal system is not sullied.

Mr. BEISNER. I am not aware of any circumstance in which the Chamber has been asked or retained by a State to——

Mr. DEUTCH. No, I am not either. I am not either.

Mr. BEISNER [continuing]. Obtain money from lawsuits.

Mr. DEUTCH. Okay, I yield back. I yield back, Mr. Chairman.

Mr. FRANKS. I thank the gentleman.

And this, actually, concludes today's hearing, so thanks to all of our witnesses for attending. And without objection, all Members will have 5 legislative days to submit additional written questions for witnesses or additional materials for the record.

And, again, I thank the witnesses. I thank the Members. I thank the audience for their attendance. And this hearing is adjourned.

[Whereupon, at 11:20 a.m., the Subcommittee was adjourned.]

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